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December 2008

Members of the General Assembly:

Prior to each session, staff of the Department of Legislative Services, Office of Policy Analysis, prepare an information report on issues. This document is a compilation of the issue papers arranged by major topic. The information reflects the status of the items as of December 1, 2008.

Following each paper is an identification of the staff who worked on a particular topic. If you should need additional information, please do not hesitate to contact the appropriate staff person.

We trust this information will be of assistance to members of the General Assembly.

Sincerely,

Karl S. Aro
Executive Director

Warren G. Deschenaux
Director

WGD/ncs

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Operating Budget

Economic and Revenue Outlook

Growth in the Maryland economy has slowed significantly over the past year. Economic performance is expected to worsen through 2009 and then improve in 2010. Since the end of the legislative session, the general fund revenue estimate for fiscal 2009 has been revised downward by \$591 million. Adjusted for law changes, fiscal 2009 revenues are expected to decline slightly from the fiscal 2008 level.

Economic Outlook

The Maryland economy slowed in 2007 with employment advancing at about half the pace of 2006. Total personal income was up a strong 6.3 percent in 2007, due to a 12.2 percent increase in income from dividends, interest, and rent. Wage income growth slowed slightly between 2006 and 2007, from 5.4 percent in 2006 to 5.0 percent in 2007.

Economic conditions in 2008 have deteriorated further. Employment grew just 0.4 percent in the first quarter. Initial claims for unemployment insurance are up almost 25.0 percent in the first nine months of 2008. The unemployment rate rose from 3.6 percent in December 2007 to 4.6 percent in September 2008. Personal income growth has slowed substantially to just 4.0 percent in the first six months of the year, and growth in wage and salary income was just 3.6 percent. Vehicle sales have fallen almost 10.0 percent in the first nine months of the year, and taxable retail sales are down 1.6 percent in the January-August period. Home sales are down around 29.0 percent for the January-September period compared to the same period in 2007. The median home price has fallen 8.0 percent in the first nine months of 2008.

In September, the Board of Revenue Estimates (BRE) issued a revised economic forecast for Maryland that was considerably weaker for 2008 to 2010 than the previous forecast issued in March. Given the global financial crisis that erupted in September and October, along with the U.S. forecasts for a deeper, longer recession, the Department of Legislative Services (DLS) developed a new Maryland forecast. Both employment and personal income growth are expected to be slightly slower than BRE's September forecast, and growth in 2009 and 2010 is expected to be considerably weaker. Employment is expected to fall 0.4 percent in 2009, which would be the first annual decline since 1992.

Exhibit 1
Maryland Economic Outlook
Forecasted Year-over-year Percentage Change

Calendar Year	Employment			Personal Income		
	March 2008	September 2008	October 2008	March 2008	September 2008	October 2008
2005	1.5%	1.5%	1.5%	5.7%	5.5%	5.8%
2006	1.2%	1.3%	1.3%	5.7%	5.7%	5.8%
2007	0.8%	0.8%	0.7%	5.7%	5.4%	6.3%
2008E	1.1%	0.6%	0.4%	4.7%	4.4%	4.3%
2009E	1.8%	0.3%	-0.4%	5.0%	3.4%	3.0%
2010E	1.9%	1.2%	1.0%	5.5%	4.9%	4.4%
2011E	1.8%	1.8%	1.8%	6.0%	5.5%	5.6%

Source: March 2008 and September 2008 from the Board of Revenue Estimates. October 2008 is from the Department of Legislative Services. The figure for 2007 for personal income under the March 2008 column is an estimate.

Revenue Outlook

Fiscal 2008 general fund revenues were below the estimate by \$71.0 million. General fund revenues totaled \$13.5 billion in fiscal 2008, an increase of 4.7 percent over 2007. Legislation from the 2007 special session made changes in the income tax, the sales tax, the corporate income tax, the tobacco tax, and some miscellaneous revenues. These changes generally went into effect in January 2008, thus impacting half of fiscal 2008. Adjusting for these law changes, it is estimated that general fund revenues in fiscal 2008 grew 1.5 percent.

The sales tax was the biggest source of weakness, falling short of the estimate by \$76.5 million and growing 7.5 percent over 2007. The sales tax rate was increased from 5.0 to 6.0 percent effective in January 2008, and the sales tax vendor credit was capped at \$500 per month. In addition, \$50.0 million of sales tax receipts was transferred to a special fund to pay for the replacement of State Police helicopters. Adjusted for those law changes, fiscal 2008 general fund sales tax receipts fell by about 0.3 percent, the first decline since fiscal 1991. In addition to the general economic weakness, the sales tax was likely impacted by high gasoline and food prices that pulled spending away from taxable goods and services.

Fiscal 2009 has gotten off to a slow start. Total general fund revenues through September are up 7.4 percent over the same period in 2008. However, the various law changes passed at the 2007 special session and the 2008 session that are now in effect were not in effect

in November 2007. After adjusting for those changes, growth in the first few months of fiscal 2009 is around 1.3 percent.

The significant under attainment in fiscal 2008, combined with the weak year-to-date performance and deteriorating economic conditions, results in a substantial downward revision to the general fund forecast for fiscal 2009. Legislation passed at the 2007 special session requires BRE to formally issue a new general fund revenue forecast each September. BRE's September estimate for fiscal 2009 was almost \$432.0 million less than its previous estimate. Growth over fiscal 2008 was revised down from 6.6 to 4.0 percent. BRE forecasted growth of 1.4 percent in fiscal 2009 after adjusting for law changes.

In preparing a general fund revenue forecast for the October 2008 meeting of the Spending Affordability Committee, DLS relied on the revised economic outlook discussed earlier to modify BRE's September forecast for the most economically sensitive revenue sources: the income tax, the sales tax, the corporate income tax, and interest earnings. DLS utilized the September BRE estimates for all other general fund revenue sources. In total, DLS' estimate for fiscal 2009 is \$159.0 million below BRE's September forecast and reflects total growth of 2.8 percent, with a baseline decline of 0.4 percent relative to fiscal 2008.

In September, BRE issued a general fund revenue estimate for fiscal 2010 that projects a 4.3 percent increase over fiscal 2009. DLS' estimate for fiscal 2010 is \$288.3 million below the September estimate, with estimated growth of 3.5 percent. The personal income tax estimate is lower by \$165.5 million reflecting the weaker economic outlook for calendar 2009 and 2010. The sales tax estimate is down \$95.0 million from BRE's estimate. Sales tax growth is projected to be just 1.6 percent, substantially slower than the 3.8 percent growth in the September estimate. This again reflects the deteriorating economic outlook, with the timing of the recovery expected to be later than previously thought.

Exhibit 2
Maryland General Fund Revenue Forecast
Fiscal 2009-2010
(\$ in Millions)

	FY 2009				FY 2010	
	<u>Current</u>	<u>DLS</u>		<u>Percent</u>	<u>DLS</u>	<u>Percent</u>
	<u>Official</u>	<u>October</u>		<u>Change</u>	<u>October</u>	<u>Change</u>
	<u>Estimate</u>	<u>2008</u>	<u>Difference</u>	<u>2009/2008</u>	<u>2008</u>	<u>2010/2009</u>
Personal Income Tax	\$7,310	\$7,250	-\$60	4.5%	\$7,532	3.9%
Sales and Use Tax	3,787	3,777	-11	2.8%	3,838	1.6%
Corporate Income Tax	673	612	-61	10.9%	737	20.4%
Lottery	495	495	0	-0.4%	508	2.5%
Other	1,824	1,796	-28	-4.6%	1,799	0.2%
Total	\$14,089	\$13,930	-\$159	2.8%	\$14,414	3.5%
Estimated Baseline Percent Change				-0.4%		3.4%

Note: The current official estimate for fiscal 2009 was issued by the Board of Revenue Estimates in September and reflects a \$432 million downward revision to their previous projection for the year. The Department of Legislative Services' estimate for fiscal 2010 is \$288 million lower than the board's fiscal 2010 estimate released in September. Estimated Baseline Percent Change accounts for law changes at the 2007 special session and 2008 session.

Source: Board of Revenue Estimates; Department of Legislative Services

Operating Budget

Budget Outlook: Economic Downturn Dims the Fiscal Outlook

A global financial crisis has resulted in significant downward revisions in general fund revenues in calendar 2008, and further losses are likely. While a constitutional amendment to permit video lottery terminals was passed by the voters in November 2008, persistent structural deficits are projected through fiscal 2014 in excess of \$800 million. The Board of Public Works reduced fiscal 2009 spending in June and October by nearly \$350 million in general funds, and additional cuts are expected. Restoring budgetary balance will require a multi-year plan.

Background

Facing a structural general fund deficit estimated as high as \$1.7 billion, Governor Martin J. O'Malley called the legislature into a special session in November 2007. Final actions yielded an estimated \$850.0 million in new revenues, chiefly due to a 1-cent increase in the sales tax, and over \$700.0 million in net spending reductions. However, a continued slump in the housing market and a subprime mortgage lending crisis combined to impact the construction and financial sectors of the economy. The Board of Revenue Estimates (BRE) revised fiscal 2008 revenues downward by \$75.0 million; however, at closeout, revenue fell by another \$71.2 million – largely in income and sales taxes. The fiscal 2008 budget closed with an undesignated general fund surplus of \$487.1 million, which was approximately \$50.0 million lower than expected.

At the 2008 session, revenues were further revised downward by BRE in excess of \$250 million but were addressed by spending reductions. Chapter 10 of 2008 repealed the computer sales tax but offset the revenue loss with a three-year increase in the income tax rate for income in excess of \$1 million, a five-year diversion of sales tax revenue from the Transportation Trust Fund to the general fund, and \$50 million in budget reductions which were adopted by the Board of Public Works (BPW) in June 2008.

Despite a federal economic stimulus program in the spring of 2008, the revenue picture continued to worsen, and by September 2008, BRE revised revenues downward by another \$432 million. This prompted the Governor, through BPW, to withdraw \$297 million in general fund spending. Turmoil continued in the financial sector, as the subprime mortgage crisis led to the failure or near failure of investment firms, a major insurer, and several banks. A major federal bailout plan was put into effect, but credit markets have tightened amid continued concerns over mortgage defaults. In November 2008, voters passed the constitutional amendment to permit up to 15,000 video lottery terminals (VLTs) at five locations in the State. When fully implemented, an estimated \$660 million will flow into State coffers by fiscal 2013.

In the short-term though, the Department of Legislative Services (DLS) has estimated that fiscal 2009 revenues will continue to weaken, but the extent of additional revisions will not be fully known until the next update by BRE in mid-December.

Fiscal 2009-2014 Forecast: Difficult Times Ahead

Exhibit 1 provides the DLS forecast for the 2009-2014 period. Despite the withdrawn appropriations by BPW, DLS projects that the current fiscal year will require an additional \$138 million in additional revenue or spending actions in order to achieve balance. Continued weakness in ongoing revenues suggests that a shortfall in excess of \$1.2 billion may be expected in fiscal 2010. While economic recovery is accounted for in the forecast, the receipt of VLT revenues, beginning in earnest in fiscal 2012, is the main driver behind lower projected deficits. Structural shortfalls are expected to persist in the range of \$800 million, which will require a multi-year plan toward longer-term structural balance.

Exhibit 1 General Fund Projections Fiscal 2009-2014 (\$ in Millions)

	<u>2008 Actual</u>	<u>2009 Working</u>	<u>2010 Baseline</u>	<u>2011 Est.</u>	<u>2012 Est.</u>	<u>2013 Est.</u>	<u>2014 Est.</u>	<u>Avg. Annual Change 2010-2014</u>
Revenues								
Opening Fund Balance	\$285	\$487	\$0	\$0	\$0	\$0	\$0	
Transfers	996	149	248	59	45	49	55	
BPW Transfers from October 15, 2008	0	99	0	0	0	0	0	
One-time Revenues/Legislation	150	51	0	0	0	0	0	
Subtotal One-time Revenue	\$1,430	\$786	\$248	\$59	\$45	\$49	\$55	
Ongoing Revenues	\$13,545	\$13,905	\$14,413	\$15,266	\$16,074	\$16,942	\$17,753	
Net Video Lottery Terminal Revenues	0	0	90	70	453	605	623	
Subtotal Ongoing Revenue	\$13,545	\$13,905	\$14,503	\$15,336	\$16,527	\$17,547	\$18,377	6.1%
Total Revenues and Fund Balance	\$14,975	\$14,691	\$14,751	\$15,395	\$16,572	\$17,597	\$18,432	
Ongoing Spending								
Operating Spending	\$14,183	\$14,842	\$15,818	\$16,698	\$17,427	\$18,258	\$19,169	
Health Care Expansion ¹	0	0	0	68	187	204	214	
BPW Reductions from October 15, 2008 ²	0	-275	-119	-141	-160	-165	-169	
Multi-year Commitments	115	100	78	64	0	0	0	
Subtotal Ongoing Spending	\$14,298	\$14,666	\$15,777	\$16,688	\$17,455	\$18,297	\$19,214	5.1%
One-time Spending								
PAYGO Capital	\$27	\$16	\$25	\$38	\$38	\$37	\$37	
Appropriation to Reserve Fund	163	147	176	50	50	50	50	
Subtotal One-time Spending	\$190	\$163	\$201	\$88	\$88	\$87	\$87	
Total Spending	\$14,488	\$14,829	\$15,978	\$16,776	\$17,543	\$18,384	\$19,301	
Ending Balance	\$487	-\$138	-\$1,226	-\$1,381	-\$971	-\$788	-\$870	

Exhibit 1 (continued)

	2008	2009	2010	2011	2012	2013	2014	Avg.
	<u>Actual</u>	<u>Working</u>	<u>Baseline</u>	<u>Est.</u>	<u>Est.</u>	<u>Est.</u>	<u>Est.</u>	<u>Annual</u>
								<u>Change</u>
								<u>2010-2014</u>
Rainy Day Fund Balance	\$685	\$732	\$721	\$767	\$827	\$877	\$918	
Balance over 5% of GF Revenues	3	36	0	0	0	0	0	
As % of GF Revenues	5.02%	5.26%	5.00%	5.00%	5.00%	5.00%	5.00%	
Structural Balance	-\$753	-\$762	-\$1,273	-\$1,352	-\$928	-\$750	-\$838	

¹Chapter 7 of the 2007 special session expresses the intent that the expansion of health care services continue beyond fiscal 2009, subject to specified general fund and education trust fund (from video lottery terminals) revenue attainments. Current revenue estimates fall short of the attainment specified in the bill.

²The Board of Public Works reduced \$22.3 million in Medicaid expenditures. However, the Department of Legislative Services' baseline already assumed \$22.3 million in Medicaid funds would be used to offset the fiscal 2009 estimated Medicaid deficiencies.

BPW: Board of Public Works

GF: general fund

PAYGO: pay-as-you-go

Source: Department of Legislative Services

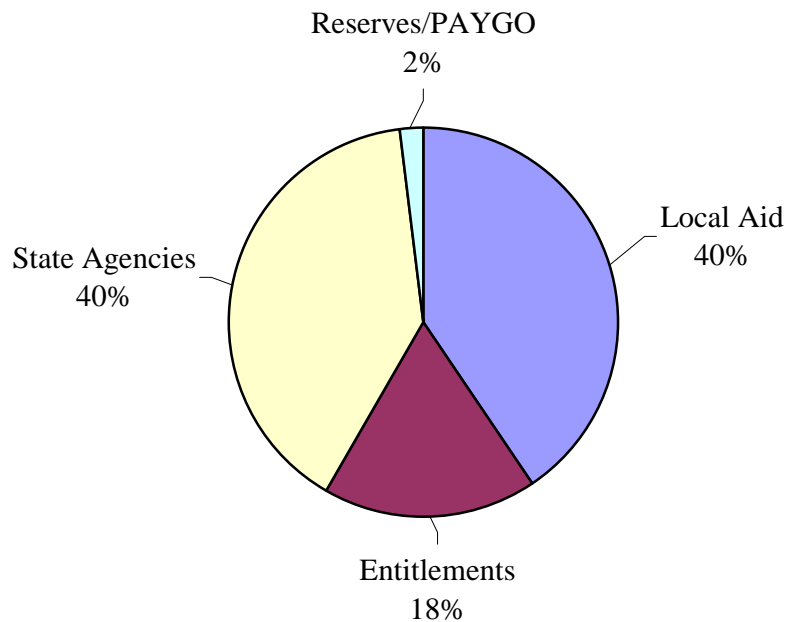
Solving the Structural Deficit

Ideally, a plan to address the shortfall should include a combination of actions involving ongoing revenues, ongoing spending reductions, and one-time transfers, such as the use of reserves, where appropriate. The enactment of major tax and fee increases at the 2007 special session lessens the likelihood of major tax increases. However, revenue actions that may be considered could include selected fee increases, additional tax compliance measures, and potential expansion of the sales tax to selected services. Although the State has over \$700 million set aside in the Rainy Day Fund, the use of this one-time revenue will not solve the ongoing imbalance shown in the forecast. However, it is appropriate to use portions of reserve fund balances or to transfer other fund balances as part of the solution.

Ongoing reductions to the operating budget will require an approach that examines the three major cost centers: local aid, entitlements, and State agency operations.

As shown in **Exhibit 2**, local aid comprises 41 percent of the \$14.8 billion fiscal 2009 general fund budget, followed closely by the State agencies at 40 percent. Entitlement programs constitute approximately 18 percent of the budget.

Exhibit 2
Allocation of General Fund Spending
Fiscal 2009 \$14.8 Billion Working Appropriation
Local Aid and Entitlement Programs Consume 59 Percent of the Budget
Fiscal 2009 Working



PAYGO: pay-as-you-go

Source: Department of Legislative Services

Conclusion

Action at the 2007 special session largely addressed an estimated \$1.7 billion general fund structural deficit, but since then, a downturn in the economy has eroded the State's revenue picture. A \$1.3 billion shortfall is predicted for fiscal 2010. Although, the outlook improves somewhat due to the passage of a constitutional amendment to permit video lottery terminals, difficult choices lie ahead. Nearly 60 percent of the general fund budget is allocated to local aid and entitlement programs. A multi-year plan that encompasses revenues, spending cuts, and one-time transfers will need to be contemplated in order to restore fiscal balance.

Operating Budget

Transportation Trust Fund Overview

The Transportation Trust Fund's ending cash balance for fiscal 2008 did not meet expectations, as revenues declined due to deteriorating economic conditions and high gas prices, and the transportation revenue estimates for fiscal 2009 have recently been revised downward. These lower than anticipated revenue attainments and expected modest revenue growth beyond fiscal 2009 will likely create constraints on debt issuances and a reduced transportation capital program through fiscal 2014.

Fiscal 2008 Closeout

The Transportation Trust Fund (TTF) closed fiscal 2008 with a balance of \$53 million, \$47 million less than the administrative level of \$100 million. State-sourced revenues declined \$96 million, or 4.3 percent, from budget estimates due to a downturn in the economy and higher gasoline prices, which affected both fuel consumption and vehicle purchases. Titling tax revenues were down by \$64 million (9.0 percent less than estimated), while motor fuel tax revenues were \$9 million less than the estimate. Other major revenue changes included a smaller than expected bond sale and an increase in operating and miscellaneous revenues.

Operating budget expenditures were \$27 million more than expected due to higher than expected winter maintenance costs and diesel fuel costs. The capital budget was \$74 million less than estimated – most of the reduction was due to additional federal fund attainment, which reduced the need for special funds and cash flow changes. In addition, weak revenue attainment reduced the local share of highway user revenues by \$22 million.

Changes to the TTF Forecast Since January 2008

Several legislative changes and economic events resulted in special funds in the current draft 2009 to 2014 *Consolidated Transportation Program* (CTP) being \$1.0 billion less than in the January 2008 to 2013 CTP. The changes include the following:

- Chapter 10 of 2008 reduced the TTF share of sales tax revenues from 6.5 to 5.3 percent through fiscal 2013 and also repealed the sales tax on computer services. These statutory changes, as well as downward revisions in the sales tax estimate, reduced revenues to the TTF by \$442 million for the comparable fiscal 2009 to 2013 period.
- As the economy weakened throughout the spring and summer months of 2008, vehicle sales continued to decline and titling tax revenue was revised downward by \$420 million for the fiscal 2009 to 2013 period. Motor fuel tax revenues were also revised downward by \$121 million, due to a decline in vehicle miles traveled.

TTF Forecast for Fiscal 2009-2014

Revenues

Exhibit 1 shows the Department of Legislative Services' (DLS) fiscal 2009 to 2014 TTF forecast. The forecast details the expected trends in revenue attainment, debt issuance, and capital expenditures. Overall, underlying revenues are expected to decline dramatically in fiscal 2009 due to economic weakness; however, when comparing fiscal 2008 to 2009, revenues actually grow due to the introduction of new sales tax revenues in fiscal 2009. The decline in revenue growth coupled with higher estimates of operating budget growth has implications for future debt issuances and the capital program.

Over the six-year period, DLS estimates that total tax and fee revenue will total approximately \$11.4 billion, with average annual growth of 3.3 percent. Titling tax revenue is estimated to decline 10.1 percent in fiscal 2009 and grow 0.9 percent in fiscal 2010. The decline in fiscal 2009, coupled with moderate estimates of growth in the out-years, results in revenues being about \$1.0 billion less than the Maryland Department of Transportation's (MDOT) September estimate. Motor fuel tax revenues are also revised downward by \$139 million compared to the MDOT September estimate. The downward revision for each revenue source can be attributed to higher gas prices reducing vehicle miles traveled, individuals delaying vehicle purchases or purchasing more fuel efficient and/or less expensive vehicles, and lower consumer confidence due to the weakening economy.

Debt Financing

Debt issuances by MDOT are limited by a total debt outstanding cap of \$2.6 billion and two coverage tests that require the prior year's pledged taxes and net income to be two and a half times greater than the maximum debt service in a given fiscal year. Due to downward revisions in revenues and higher estimates of operating expenses, future bond issuances are constrained. DLS estimates that total bond sales will be approximately \$1.2 billion less than MDOT's estimate over the six years, with the revenue loss reflected in the capital program.

Operating and Debt Service Expenditures

Operating and debt service expenditures are the first draw on TTF revenues. Over the six-year period, operating and debt service expenditures are estimated to total \$11.8 billion. When compared to MDOT's estimate for operating budget expenditures, DLS estimates that expenditures will be \$464 million more than the MDOT estimate. The average annual growth rate for these expenditures is 5.4 percent, compared to tax and fee revenue growth of 3.3 percent. As expenditure growth outpaces revenue growth, there is less cash available for the capital program over the six-year period.

Exhibit 1
Transportation Trust Fund Forecast
Fiscal 2009- 2014
(\$ in Millions)

	Actual 2008	Estimate 2009	Estimate 2010	Estimate 2011	Estimate 2012	Estimate 2013	Estimate 2014
Opening Fund Balance	\$190	\$53	\$100	\$100	\$100	\$100	\$100
Closing Fund Balance	\$53	\$100	\$100	\$100	\$100	\$100	\$100
Net Revenues							
Taxes and Fees	\$1,539	\$1,769	\$1,795	\$1,868	\$1,920	\$1,980	\$2,077
Operating and Miscellaneous	533	512	521	531	542	553	557
MDTA Transfer	30	30	30	0	0	0	0
Net Revenues Subtotal	2,042	2,251	2,286	2,399	2,462	2,533	2,634
Bonds Sold	227	360	120	50	40	30	20
Bond Premiums	23	0	0	0	0	0	0
Total Revenues	\$2,292	\$2,611	\$2,406	\$2,448	\$2,502	\$2,564	\$2,655
Expenditures							
Debt Service	\$119	\$142	\$152	\$161	\$178	\$181	\$198
Operating Budget	1,488	1,577	1,676	1,758	1,845	1,936	2,033
State Capital	822	845	578	529	480	445	421
Total Expenditures	\$2,429	\$2,564	\$2,406	\$2,448	\$2,503	\$2,563	\$2,653
Debt							
Debt Outstanding	\$1,269	\$1,553	\$1,595	\$1,562	\$1,500	\$1,422	\$1,312
Debt Coverage – Net Income	4	3	3	3	3	3	3
Local Highway User Revenues	\$530	\$496	\$501	\$519	\$529	\$540	\$543
Capital Summary							
State Capital	\$822	\$845	\$578	\$529	\$480	\$445	\$421
Net Federal Capital (Cash Flow)	671	641	564	449	359	375	358
Subtotal Capital Expenditures	\$1,493	\$1,486	\$1,142	\$978	\$839	\$820	\$779
GARVEE Debt Service	36	73	84	84	84	84	84

GARVEE: Grant Anticipation Revenue Vehicles

MDTA: Maryland Transportation Authority

Source: Department of Legislative Services

Capital Expenditures

DLS estimates that the special and federal fund capital program will total \$6.0 billion over the six-year period. This is approximately \$2.5 billion less than MDOT's estimate in the draft CTP. As indicated earlier, the decline is attributed to the downward revision in revenues and higher estimates for operating expenses, each of which constrains MDOT's ability to issue debt.

In fiscal 2009, the capital program is largely maintained through a \$360 million bond sale and will total almost \$1.5 billion. After fiscal 2009, the capital program significantly decreases, with the program estimated to be just over \$1.1 billion in fiscal 2010 and declining to \$779 million by fiscal 2014.

The capital program could increase if MDOT undertakes cost containment actions of an ongoing nature in the operating budget. In doing so, cash is made available for the capital program and bonding capacity also increases. Furthermore, current federal aid estimates are quite conservative given the long-term concerns regarding the solvency of the federal transportation aid account. To the extent that a favorable long-term solution for federal funding is identified in the coming year, or funding for transportation infrastructure is included in a second federal economic stimulus package, funding for the capital program could increase.

Operating Budget

Federal Assistance to States: Outlook for Economic Stimulus and Fiscal Relief

At least 41 states now face budget problems. The U.S. Congress has appropriated funds for federal government programs and obligations through March 2009, primarily under a continuing resolution, but most federal programs providing state funding continue to be funded at federal fiscal 2008 levels. During the last recession, the State received \$350 million in financial assistance from the federal government as general assistance and through the Medicaid program. State assistance is again under discussion at the federal level, and could be sizeable and focused on both economic stimulus and fiscal relief, including additional funding for infrastructure projects, food stamps, and Medicaid.

State Budgets Continue to Fall Short

As the national economy continues to struggle, a majority of state budgets are showing strain as well. States facing shortfalls have responded with spending cuts or revenue increases to balance their budgets. Despite these efforts, 41 states, including Maryland, still face budget shortfalls in their fiscal 2009 or 2010 budgets, according to the Center on Budget and Policy Priorities. Unless the national economy takes an immediate and dramatic turn for the better, states will continue to face a fiscal crisis over at least the next year. In an attempt to minimize the damage from such a crisis, federal policymakers are considering a major new economic stimulus package that would respond to the states' pressing needs. As of early December 2008, however, federal aid has mostly remained flat.

Federal Fiscal 2009 Aid for States Mostly Flat, but More Aid Possible

On September 30, 2008, the Consolidated Security, Disaster Assistance, and Continuing Appropriations Act of 2009 was signed into law. The bill includes full-year appropriations for defense, military construction, veterans' affairs, and homeland security but funds the remaining nine appropriations bills under a continuing resolution (CR) through March 6, 2009. These remaining bills contain the bulk of federal grants to state and local governments in areas such as education, social services, health, law enforcement, and the environment. The CR contains no earmarks, a traditional source of extra federal income for state and local projects and funds most state-federal programs at federal fiscal 2008 levels, with a few exceptions. Increases in funding are included for the following programs:

- Low-Income Home Energy Assistance Program (LIHEAP);
- Weatherization Assistance;

- Supplemental Nutrition Assistance for Women, Infants, and Children;
- Commodity Supplemental Food Program; and
- Pell Grants.

An increase of \$2.5 billion in the CR for the LIHEAP effectively doubles the funding level provided to the states in fiscal 2008. LIHEAP funding helps low-income families pay their home energy bills. Eligibility is currently capped at 150 percent of the national poverty line, although the CR allows a state to increase eligibility to 75 percent of the state's median income. The increase in LIHEAP funding translates into a \$73 million (or 204 percent) increase in funds for Maryland over fiscal 2008 levels.

Federal Assistance to States – Past as Prologue?

The last time states faced a similar fiscal crisis was in 2003, when Congress responded by passing the *Jobs and Growth Tax Relief Reconciliation Act of 2003*. The Act provided states with one-time fiscal assistance. Maryland received approximately \$350 million distributed between fiscal 2003 (\$123 million) and 2004 (\$227 million). This was comprised of general aid (\$90 million each year) that was used to supplant general funds in the State Police budget each year, and increased reimbursements for the Medicaid program.

Stimulus Debate Yields Extension of Unemployment Benefits

The current economic struggle has generated debate on how to stimulate the economy and support core state programs. In late September 2008, the House of Representatives passed a \$61 billion second stimulus package, although a similar bill stalled in the Senate and also faced the threat of a presidential veto. The House bill would have allowed a temporary increase of 1 percent in the federal matching rate for Medicaid, resulting in a \$14 billion savings for states. It would have also provided additional funding for (1) highway infrastructure; (2) aid to public schools; (3) public housing programs; (4) an extension of unemployment benefits; (5) job training programs; and (6) food stamps.

On November 20, during the lame-duck session of Congress, the President signed into law a bill to extend unemployment benefits for up to three months to people whose unemployment benefits have run out or are about to expire. The move was at least partly in response to the U.S. Department of Labor's recent report that new claims for jobless aid have reached a 16-year high.

New Economic Stimulus Package Would Likely Aid States

President-elect Barack Obama has called for a major new federal spending initiative to stimulate the faltering economy and create or preserve 2.5 million jobs over the next two years. While Obama has not said exactly how large the stimulus package should be or precisely how the money should be spent, congressional leaders are reportedly considering spending up to \$700 billion. The congressional leadership hopes to pass the plan quickly after the 111th Congress convenes in January so that President-elect Obama can sign it shortly after taking office January 20.

Any new economic stimulus plan is likely to include substantial new assistance to the states. While policymakers are discussing a wide variety of proposals that would assist states, Medicaid, infrastructure, and food stamp aid are the most discussed alternatives.

Medicaid

Any assistance to state Medicaid programs would likely come in the form of an increased federal matching rate, similar to that given under the *Jobs and Growth Tax Relief Reconciliation Act of 2003*. Under the 2003 law, each state was provided a 2.95 percent increase in the federal match, which translated into \$170 million federal relief dollars to Maryland over fiscal 2003 and 2004. A comparable increase would be a great help to states facing increasing Medicaid costs. It would be especially helpful to Maryland in supporting the Medicaid expansion passed during the 2007 special session.

Infrastructure

Federal funds for state infrastructure projects are likely to be an important component of any economic stimulus package. President-elect Obama advocates spending on highways, bridges, school construction, and alternative energy projects as a way to create jobs in the short term. Spending \$1.0 billion on transportation infrastructure creates 35,000 jobs and generates \$5.7 billion in additional economic activity, according to the National Governor's Association. Spending on other kinds of infrastructure, such as water systems and public housing, could also be included.

Federal spending is likely to be focused on projects that are ready for construction in the next several months and therefore will have a rapid impact on the economy. In Maryland, federal assistance would likely be used to restore some of the \$1.1 billion in projects recently cut from the State's six-year transportation program due to falling tax revenue. Federal aid for transportation infrastructure would likely be provided through existing federal programs, but Congress may choose to temporarily suspend requirements that states provide matching funds to access federal dollars. This would benefit states such as Maryland with revenue shortfalls that may have difficulty providing funds for the federal match. Congress could also choose to inject an additional \$9 billion into the federal Highway Trust Fund to ensure its solvency over the next

two years. This would give states confidence they will receive timely reimbursement in the future for new projects.

Food Stamps

The worsening economic climate, combined with increased outreach efforts, have led to steady increases in the number of food stamp recipients over the past two years. In Maryland, there were 306,002 people receiving food stamp assistance in July 2006. By September 2008 this number had grown to 389,298. This increase reflects a national trend, with the number of people receiving food stamps soon expected to be higher than ever before. Food stamp benefits are funded entirely by the federal government. In fiscal 2008, almost \$410 million was spent on food stamps in Maryland. Federal aid for the food stamp program would likely come in the form of increased benefits or increased eligibility, allowing more low-income individuals access to food stamps. This would benefit all states since food stamp assistance translates directly into purchases that support not only the consumer, but the local economy.

Capital Program

Debt Affordability

The Capital Debt Affordability Committee recommended a general obligation bond debt limit totaling \$1.11 billion for fiscal 2010. This represents a \$175 million increase from the \$935 million limit recommended for fiscal 2009. Twenty-five million of the increase is the result of the 3 percent annual escalation, and \$150 million is recommended for the purpose of expanding the capital program.

Capital Debt Affordability Process

State law requires the Capital Debt Affordability Committee (CDAC) to review the size and condition of all tax-supported debt to ensure that the State's tax-supported debt burden remains affordable. The committee is composed of the Treasurer, the Comptroller, the secretaries of Transportation and Budget and Management, and a public member. Chapter 445 of 2005 added, as nonvoting members, the chairs of the Capital Budget Subcommittees for the Senate Budget and Taxation Committee and the House Committee on Appropriations.

Tax-supported debt consists of general obligation (GO) debt, transportation debt, Grant Anticipation Revenue Vehicles (GARVEEs), bay restoration bonds, capital leases, Stadium Authority debt, and bond or revenue anticipation notes. The committee makes annual, nonbinding recommendations to the Governor and the General Assembly on the appropriate level of new GO and academic revenue debt for each fiscal year. The committee does not make individual recommendations on the levels of capital leases, transportation debt, bay restoration bonds, or Stadium Authority debt but does incorporate the anticipated levels of these types of debt in its analysis of total debt affordability.

Revised Affordability Criteria

Since 1979, CDAC policy has been to limit State debt outstanding to 3.2 percent of personal income and State debt service to 8.0 percent of State revenues. Since these criteria were developed, the State has added new types of tax-supported debt, such as Stadium Authority and bay restoration bonds. These new types of bonds, as well as increased GO bond authorizations, would have increased debt outstanding in excess of 3.2 percent of personal income, beginning in fiscal 2010.

In response to a request from the General Assembly, the committee began a review of the debt affordability criteria in 2007. The committee consulted with rating agencies, investment bankers, and its financial advisor. The committee determined that two criteria were no longer ideal and in its 2008 report recommended revising the criteria so that State debt outstanding not exceed 4 percent of State personal income. No change was made to the limit on debt service.

The new policy allows the State to issue more debt but does not allow the annual costs to increase beyond the previously set limit. Since debt service has a direct budgetary impact, maintaining the debt service limit keeps debt service costs at affordable levels. Increasing the limit in debt outstanding provides additional capacity for the new types of bond programs without reducing out-year GO bond authorizations.

The committee's analysis of debt affordability for fiscal 2009 through 2014 indicates that debt outstanding peaks in fiscal 2012 at 3.43 percent of personal income and debt service peaks in fiscal 2014 at 6.84 percent, as indicated in **Exhibit 1**.

Exhibit 1
Affordability Ratios
Fiscal 2009-2014

<u>Fiscal Year</u>	<u>Projected Debt Outstanding As a Percent of Personal Income</u>	<u>Projected Debt Service As a Percent of Revenues</u>
2009	3.13%	5.97%
2010	3.28%	6.18%
2011	3.37%	6.37%
2012	3.43%	6.57%
2013	3.41%	6.76%
2014	3.35%	6.84%

Source: *Report of the Capital Debt Affordability Committee on Recommended Debt Authorizations*, November 2008

Recommended New Debt Authorizations

The committee has recommended \$1.11 billion in new GO debt authorization for fiscal 2010 which is \$175 million more than was authorized in fiscal 2009. Of the total increase, \$25 million represents a 3 percent annual increase. The remaining \$150 million increase was recommended for the purpose of supporting demand for capital program funding. The recommendation also includes the final planned \$5 million for tobacco buyout financing, as required by Chapter 103 of 2001. By the end of fiscal 2010, the committee estimates that total GO debt will be just under \$6.30 billion.

The University System of Maryland (USM), Morgan State University, and St. Mary's College of Maryland have the authority to issue debt for academic facilities as well as auxiliary facilities. Proceeds from academic debt issues are used for facilities that have an education-related function, such as classrooms. Debt service for these bonds is paid with tuition and fee revenues. For the 2009 session, CDAC recommends \$27 million for academic facilities on USM campuses.

Transportation bonds are limited obligation instruments, the proceeds of which fund highway and other transportation-related projects. Debt service on these bonds is funded from motor vehicle fuel taxes, titling and registration fees, a portion of the corporate income tax, and

other Maryland Department of Transportation revenues. The gross outstanding aggregate principal amount of Consolidated Transportation Bonds is limited by statute to \$2.6 billion. CDAC projects that total outstanding transportation debt is projected to reach almost \$2.0 billion in fiscal 2010. The department also issued the first GARVEE bonds in fiscal 2008. Chapters 471 and 472 of 2005 limit the total amount of GARVEEs that may be issued at \$750 million. The State pledges anticipated federal revenues to support the GARVEEs debt service, and statute specifies that the bonds are considered tax-supported debt.

The Bay Restoration Fund was created by Chapter 428 of 2004 to provide grants for Enhanced Nutrient Removal pollution reduction upgrades at the State's major wastewater treatment plants. The fund has several revenue sources and expends funds for both operating and capital program purposes. The Maryland Department of the Environment indicates that the estimated issuance stream is \$50 million, \$70 million, \$80 million, \$150 million, and \$180 million in fiscal 2008 through 2012, respectively.

Capital leases for real property and equipment are secured by the assets leased and are paid with appropriations made to the agencies using the leased items. Debt outstanding for leases is expected to be \$268 million at the end of fiscal 2010.

Finally, Stadium Authority debt is also limited obligation debt and represents bonds sold for the construction of the Camden Yards baseball and football stadiums, the Baltimore and Ocean City convention centers, the Hippodrome Theater, and the Montgomery County Conference Center. The facilities' debt service is supported by lottery revenues and other general fund sources. Stadium Authority debt outstanding is expected to be \$236 million at the end of fiscal 2009.

Capital Program

Capital Funding Requests Exceed Resources

As in previous years, capital budget requests exceed the level of authorizations deemed affordable by the Capital Debt Affordability Committee. The 2009 session's General Obligation bond authorization totals \$1.11 billion, an increase of \$175 million over the 2008 authorization. This includes a one-time \$150 million supplemental authorization. Given the projected revenue shortfalls in the general fund budget, the General Assembly may consider using this one-time bond authorization to offset the general fund deficit.

General Obligation Bonds

The Capital Debt Affordability Committee (CDAC) has recommended a \$1.11 billion limit on the amount of new general obligation (GO) debt authorizations by the 2009 General Assembly to support the fiscal 2010 capital program. The limit includes \$5 million for tobacco buyout financing as required by law (Chapter 103 of 2001 as amended by Chapter 47 of 2006).

The long-range plan adopted by the committee for new annual GO bond authorizations provides for a one-time \$150 million increase over the level recommended by the committee in its 2007 report for fiscal 2010. This amount will not remain in the base permanently, as the committee recommends GO bond authorizations return to levels recommended in the committees' 2007 report, beginning with the 2010 session. Despite the increased authorizations provided in the five-year forecast period, GO bond funding requests exceed the projected limits by \$365.5 million for fiscal 2010 and by almost \$3.2 billion during the forecast period. **Exhibit 1** provides a summary of the GO bond requests for the next five years.

Exhibit 1
General Obligation Bond Requests Fiscal 2010-2014
(\$ in Millions)

	Fiscal Years						Category
	<u>2010</u>	<u>2011</u>	<u>2012</u>	<u>2013</u>	<u>2014</u>	<u>Total</u>	<u>Totals</u>
State Facilities							\$745.2
Board of Public Works	\$73.5	\$124.3	\$163.7	\$76.9	\$291.7	\$730.0	
Military	4.2	0.0	0.0	0.0	0.0	4.2	
Department of Disabilities	1.6	1.6	1.6	1.6	1.6	8.0	
Department of Information Technology	1.0	0.5	0.5	0.5	0.5	3.0	
Health and Social Services							\$597.6
Health and Mental Hygiene	\$18.5	\$24.7	\$84.1	\$84.1	\$56.7	\$268.1	
University of Maryland Medical System	13.5	13.5	10.0	10.0	5.0	52.0	
Senior Citizen Activity Center	1.9	2.0	2.0	2.0	2.0	9.9	
Juvenile Justice	62.4	53.7	56.6	60.5	9.3	242.5	
Private Hospital Grant Program	5.0	5.0	5.0	5.0	5.0	25.0	
Environment							\$424.9
Natural Resources	\$24.4	\$16.0	\$13.0	\$13.0	\$13.0	\$79.4	
Agriculture ¹	13.0	8.0	8.0	9.0	9.0	47.0	
Environment	34.0	44.0	51.0	51.0	56.0	236.0	
Maryland Environmental Service	18.5	14.0	10.0	9.5	10.5	62.5	
Education							\$2,842.3
Education	\$10.2	\$10.2	\$5.0	\$5.0	\$5.2	\$35.5	
Maryland School for the Deaf	6.3	1.5	0.0	0.0	0.0	7.8	
Public School Construction ²	440.6	493.46	552.7	619.0	693.3	2,799.0	
Higher Education							\$2,443.1
University System of Maryland ³	\$218.2	\$273.2	\$201.5	\$253.5	\$357.0	\$1,303.4	
Baltimore City Comm. College	3.9	42.3	12.3	2.7	32.8	94.0	
St. Mary's College	2.4	3.5	6.4	27.1	2.8	42.3	
Morgan State University	78.4	109.5	49.0	90.4	27.5	354.7	
Community Colleges	145.3	95.2	95.3	100.2	139.0	575.0	
Southern MD Higher Education Center	1.2	3.6	0.8	0.0	0.0	15.6	
Private Facilities Grant Program	10.0	12.0	12.0	12.0	12.0	58.0	
Public Safety							\$642.2
Public Safety	\$68.4	\$86.9	\$104.9	\$91.8	\$105.9	\$458.0	
State Police	13.3	1.3	13.2	1.4	9.5	38.7	
Local Jails	35.0	33.0	40.9	22.4	14.3	145.5	
Housing and Economic Development							\$106.0
Housing and Community Development	\$22.5	\$11.0	\$11.0	\$11.0	\$10.5	\$66.0	
Canal Place	0.0	2.1	0.0	0.0	0.0	2.1	
Historic St. Mary's City	0.2	0.3	1.4	11.0	9.8	22.6	
Planning	2.6	5.6	1.0	4.6	1.4	15.3	
							\$655.7
Legislative Initiatives⁴	\$100.0	\$100.0	\$100.0	\$100.0	\$100.0	\$500.0	
Miscellaneous	45.6	31.0	19.5	14.0	45.6	155.7	
Subtotal Request	\$1,475.5	\$1,632.9	\$1,632.3	\$1,689.4	\$2,026.8	\$8,457.0	\$8,457.0
Debt Affordability Limits	\$1,110.0	\$990.0	\$1,020.0	\$1,050.0	\$1,080.0	\$5,250.0	
Variance	\$365.5	\$642.9	\$612.3	\$639.4	\$946.8	\$3,207.0	

¹The Department of Agriculture request includes the Tobacco Transition Program.

²The Interagency Committee on School Construction received requests in excess of \$470 million for fiscal 2010; however, the amount included in the request to the Department of Budget and Management reflects base funding of \$250 million plus 12 percent annual increase attributable to construction escalation from the base fiscal 2005.

³In addition to the general obligation bond request, the University System of Maryland has requested academic revenue bond funding of \$27.0 million for fiscal 2010 and \$27.0 million annually for fiscal 2011 to 2014.

⁴ These figures represent an estimated average of the total funding requests received through legislative local bond bills.

Note: Numbers may not sum to total due to rounding.

Source: Department of Budget and Management

Portion of Additional CDAC GO Bond Authorization Tied to Public School Construction

Uncodified Section 11 of the Public School Facilities Act of 2004 directs CDAC to review school construction funding needs and make specific recommendations regarding additional funding for school construction when recommending the State's annual debt limit and GO bond authorization level. The committee's report recognized that the \$250 million of annual programmed GO bond authorization levels for school construction for fiscal 2010 through 2013 will achieve the State's nominal funding goal established by the Public School Facilities Act for public school construction projects. The committee also concluded that several years of building construction cost increases have increased actual school construction costs and thus the demand for school construction funding above the \$250 million level. To address the building cost escalation, the committee recommended at least \$325 million for public school construction in fiscal 2010. To reach the proposed school construction funding level, CDAC specifically tied \$75 million of the additional \$150 million of additional GO bond authorizations proposed for fiscal 2010 to increased authorization levels for school construction projects.

As required by Section 8-113 of the State Finance and Procurement Article, the Governor notified the General Assembly on the level of State debt that is advisable. The Governor accepted the recommendation of CDAC and provided a preliminary allocation of \$260 million of GO authorizations for school construction for fiscal 2010. While only advisory, the Governor's proposed allocation, while \$10 million more than the annual funding goal set in the 2004 Public School Facilities Act, is also \$65 million less than the amount recommended by CDAC for fiscal 2010 and \$67 million less than the amount authorized in fiscal 2009.

General Fund Support for the Capital Program

GO bond funds have traditionally been supplemented with State general and special fund capital appropriations pay-as-you-go (PAYGO) funds authorized in the annual operating budget. The use of operating funds to finance capital projects and programs can reduce debt issuance and enable the State to avoid Internal Revenue Service limits on the use of tax-exempt bonds for "private activity" purposes such as economic development and housing programs. Restrictions imposed under the federal Tax Reform Act of 1986 generally prevent the use of tax-exempt bond proceeds to finance environmental, housing, and economic development revolving loan programs. Funding for these items is, therefore, typically requested from general and special PAYGO funds. Additionally, repayment to counties for school construction costs already incurred (forward funded construction) must be made with PAYGO or other alternatives to tax-exempt debt. PAYGO may also be used to fund any capital project based on fund availability.

Exhibit 2 shows the fiscal 2005 through 2009 general fund capital PAYGO appropriation and PAYGO general fund estimates according to the 2008 *Capital Improvement Program* (CIP) for fiscal 2010. Despite an increase in the fiscal 2007 budget, the use of general funds to support the capital program remains at historically low levels.

Exhibit 2
General Fund PAYGO¹
Fiscal 2005-2009 Appropriations
Fiscal 2010 CIP Estimates
(\$ in Millions)

<u>Function</u>	<u>2005 Approp.</u>	<u>2006 Approp.</u>	<u>2007 Approp.</u>	<u>2008 Approp.</u>	<u>2009² Approp.</u>	<u>2010 Planned</u>
State Facilities	\$0.0	\$0.6	\$22.6	\$9.6	\$0.0	\$10.1
Health/Social	0.0	3.0	0.0	0.0	0.0	0.0
Environment	0.0	0.0	15.1	7.3	8.4	8.5
Education	0.0	0.0	0.0	2.0	0.0	0.0
Higher Education	0.0	1.9	19.1	0.0	0.0	0.0
Public Safety	1.0	0.0	1.4	0.0	0.0	0.0
Housing	0.0	0.0	40.0	8.3	4.3	20.1
Econ. Development	0.0	0.0	2.5	0.0	0.0	0.0
Local Projects	0.2	0.0	30.1	0.0	1.0	0.0
Total	\$1.2	\$5.5	\$130.8	\$27.2	\$13.7	\$38.7

CIP: *Capital Improvement Program*

PAYGO: pay-as-you-go

¹Figures exclude general fund appropriations made to the Heritage Tax Credit Fund.

²Figures include reductions taken by the Board of Public Works.

Source: Department of Budget and Management

The current CIP reflects continued low utilization of general funds in fiscal 2010. Only those capital programs that would require the issuance of taxable bonds are programmed to be funded with general funds in fiscal 2010. However, the State's fiscal situation may require consideration be given to using the GO bond program to provide solutions to various operating budget issues which would likely eliminate the use of general funds in the capital program for fiscal 2010. A portion of the additional \$150 million of new GO bond authorizations recommended by CDAC for fiscal 2010 would allow the bond program to address short-term operating budget issues including the elimination of general fund support of the capital program, the use of GO bonds to fund the planned purchase of State Medevac helicopters, and the use of bonds to fund the planned \$50 million payment to the Transportation Trust Fund.

Revenues and Taxes

Comparative Tax and Revenue Rankings

Based on data compiled by the U.S. Census Bureau, Maryland's overall revenue and spending levels in fiscal 2006 were moderate compared to other states. Maryland remains uniquely reliant on tax revenues, however, with a strong dependence on the income tax.

State and Local Government Spending and Revenues

As reflected in **Exhibit 1**, total State and local government spending and revenues in Maryland are not high compared to other states. Maryland ranks generally in the middle of all states in total state and local government revenues and spending measured on a per-capita basis and near the lowest in revenues and spending as a percentage of total income of residents. However, Maryland relies more on tax revenues than most states and less on nontax revenue sources.

Exhibit 1 Maryland State and Local Government Spending and Revenues 2005-2006

	<u>Maryland Rank Percent of Total</u>	<u>Maryland Rank Per Capita</u>	<u>Maryland Rank Percent of Personal Income</u>
Total Spending	n/a	25	49
Total Revenues	n/a	20	49
Revenues			
Taxes	3	9	29
Intergovernmental from Federal Government	35	33	45
Charges and Utilities ¹	44	45	49
Miscellaneous ²	45	38	50

Note: For the rankings, 1 indicates the highest and 51 the lowest.

¹Charges include higher education tuition, fees and auxiliary revenues, public hospital revenues, sewer and trash collection, highway tolls, and other user charges and fees. Utilities include gross receipts of publicly owned utilities (water, gas, electric, and transit).

²Miscellaneous revenues include interest earnings, net lottery revenues, liquor store revenues, rents, royalties, fines and forfeitures, special assessments, sale of property, and other.

Source: *State and Local Government Finances*, U.S. Bureau of the Census (July 2008)

State and Local Taxes Compared to Neighboring States

Exhibits 2 and 3 compare Maryland's State and local tax revenues in fiscal 2006 to other states in the region. Maryland's reliance on the income tax is high (third on both a percentage of income and a per-capita basis) compared to other states, primarily reflecting the statewide local income tax. Maryland ranks twenty-ninth among all states in overall state and local tax revenues as a percentage of personal income and ninth in overall tax revenues on a per-capita basis. Generally, Maryland ranks in the bottom half of all states with respect to property taxes, corporate income taxes, and sales taxes measured on a percentage of income basis. Maryland ranks twenty-seventh in property taxes, twenty-second for corporate income taxes, and forty-second on sales taxes measured on a per-capita basis. These comparisons do not incorporate the impact of changes made to taxes in Maryland or other states since fiscal 2006.

Exhibit 2
Maryland State and Local Tax Revenues
2005-2006 Tax Revenues as a Percentage of Personal Income
Comparison to Selected States

	Property Tax	Personal Income Tax	Corporate Income Tax	Sales and Selective Taxes¹	License Fees	Other Taxes²	All Taxes
Delaware							
Percent	1.6%	3.2%	0.9%	1.3%	3.0%	0.8%	10.8%
Rank	49	13	6	50	1	9	25
District of Columbia							
Percent	3.6%	3.7%	0.7%	3.7%	0.7%	1.2%	13.4%
Rank	18	4	8	25	15	5	5
Maryland							
Percent	2.4%	4.0%	0.4%	2.5%	0.3%	0.9%	10.5%
Rank	41	3	37	45	47	8	29
New Jersey							
Percent	5.1%	2.6%	0.6%	2.6%	0.5%	0.3%	11.7%
Rank	4	22	11	44	38	19	10
North Carolina							
Percent	2.4%	3.3%	0.5%	3.6%	0.5%	0.2%	10.5%
Rank	40	9	22	31	31	33	30
Pennsylvania							
Percent	3.1%	2.7%	0.5%	3.1%	0.7%	0.6%	10.7%
Rank	23	19	19	41	12	14	26
Virginia							
Percent	3.1%	3.0%	0.3%	2.7%	0.6%	0.4%	10.0%
Rank	25	16	42	43	26	18	42
West Virginia							
Percent	2.1%	2.5%	1.0%	4.4%	0.7%	0.7%	11.5%
Rank	43	24	3	13	10	11	13
United States							
Average	3.3%	2.5%	0.5%	3.8%	0.6%	0.4%	10.9%

Note: For the rankings, 1 indicates the highest. Rankings are out of 51 except for the personal income tax (out of 44) and the corporate income tax (out of 47). If the rank is "n/a," the state does not have that tax.

¹Includes the general sales tax along with selective taxes such as excise taxes on alcohol and tobacco products, motor fuel taxes, titling taxes, admissions and amusement taxes, insurance premiums taxes, public utility gross receipts taxes, and others.

²Includes death and gift taxes, documentary and stock transfer taxes, severance taxes, and other taxes.

Source: *State and Local Government Finances*, U.S. Bureau of the Census (July 2008)

Exhibit 3
Maryland State and Local Tax Revenues
2005-2006 Tax Revenues Per Capita
Comparison to Selected States

	Property Tax	Personal Income Tax	Corporate Income Tax	Sales and Selective Taxes¹	License Fees	Other Taxes²	All Taxes
Delaware							
Amount	\$622	\$1,262	\$347	\$517	\$1,180	\$315	\$4,243
Rank	44	9	5	50	1	8	15
District of Columbia							
Amount	2,073	2,105	375	2,148	395	667	7,764
Rank	4	1	4	4	3	3	1
Maryland							
Amount	1,064	1,758	151	1,111	143	376	4,603
Rank	27	3	22	42	39	6	9
New Jersey							
Amount	2,371	1,212	289	1,224	209	152	5,459
Rank	1	11	7	31	23	17	5
North Carolina							
Amount	788	1,067	147	1,164	165	53	3,384
Rank	39	14	24	37	35	37	34
Pennsylvania							
Amount	1,146	994	171	1,150	260	235	3,956
Rank	21	17	17	38	8	13	18
Virginia							
Amount	1,208	1,188	113	1,059	227	140	3,934
Rank	19	13	38	43	17	19	20
West Virginia							
Amount	586	717	295	1,242	209	204	3,252
Rank	45	32	6	29	24	14	37
United States							
Average	\$1,202	\$899	\$177	\$1,379	\$207	\$136	\$4,001

Note: For the rankings, 1 indicates the highest. Rankings are out of 51 except for the personal income tax (out of 44) and the corporate income tax (out of 47). If the rank is "n/a," the state does not have that tax.

¹Includes the general sales tax along with selective taxes such as excise taxes on alcohol and tobacco products, motor fuel taxes, titling taxes, admissions and amusement taxes, insurance premiums taxes, public utility gross receipts taxes, and others.

²Includes death and gift taxes, documentary and stock transfer taxes, severance taxes, and other taxes.

Source: *State and Local Government Finances*, U.S. Bureau of the Census (July 2008)

Revenues and Taxes

Video Lottery Terminals – Overview

After several years of debate, the Maryland General Assembly passed video lottery terminal (VLT) legislation in 2007 – a constitutional amendment that was approved by the voters in November 2008 and an implementation bill contingent on passage of the constitutional amendment. While overall VLT revenues in Delaware and West Virginia declined in fiscal 2008, Pennsylvania’s VLT program continues to expand, with additional VLT facilities scheduled to open in 2009.

Maryland Video Lottery Terminal (VLT) Legislation

Two pieces of VLT gambling legislation passed during the 2007 special session – House Bill 4 (Chapter 5) and Senate Bill 3 (Chapter 4).

House Bill 4 is a constitutional amendment approved by the voters at the November 2008 general election, proposing that the General Assembly may only authorize expanded forms of gambling subject to the following restrictions: (1) a maximum of 15,000 VLTs may be authorized; (2) a maximum of five VLT facility licenses may be issued at locations in Anne Arundel County, Baltimore City, Cecil County, Worcester County, and Rocky Gap State Park; (3) no more than one facility license may be issued in any single county or Baltimore City; and (4) VLT facilities shall comply with all applicable planning and zoning laws of the local jurisdictions.

Under the amendment, the General Assembly may not authorize any additional forms or expansion of commercial gambling, except through enactment of legislation by the General Assembly, which would then be subject to voter approval via referendum. The constitutional amendment does not apply to currently authorized forms of gambling.

Senate Bill 3 establishes the operational and regulatory framework for the proposed VLT program. Enactment of Senate Bill 3 was contingent on ratification of House Bill 4 by the voters.

Under Senate Bill 3, VLT facility licenses will be awarded by the Video Lottery Facility Location Commission, the members of which will be appointed by the Governor, President of the Senate, and Speaker of the House. Proposals for VLT facility licenses must be submitted to the Location Commission by February 1, 2009, and it is anticipated that the Location Commission will award facility licenses in the fall of 2009. Once the facility licenses are awarded, VLT operational and regulatory oversight will be provided by the State Lottery Commission. The Lottery Commission will own or lease all of the VLTs and the central monitor and control system.

Considering the timeframe within which VLT facility licenses will be awarded and the significant amount of time that will be needed for the development and construction of VLT facilities, the Department of Legislative Services estimates that VLT facilities will not likely open until sometime in calendar 2011 and will be at full implementation in calendar 2012.

Assuming that VLT facilities begin opening in calendar 2011, **Exhibit 1** details the estimated revenues that would be generated at each VLT facility for fiscal 2011 through 2013.

Exhibit 1
Estimated VLT Revenues Generated by Location
Fiscal 2011-2013
(\$ in Millions)

	<u>2011</u>	<u>2012</u>	<u>2013</u>
Anne Arundel	\$125.2	\$477.9	\$546.1
Baltimore City	0.0	265.0	426.7
Cecil	0.0	117.8	189.6
Worcester	31.4	119.8	136.9
Rocky Gap	0.0	38.7	62.3
Total	\$156.5	\$1,019.1	\$1,361.6

VLT: video lottery terminal

Source: Department of Legislative Services

Allocation of the gross VLT revenues, after payouts to bettors, is as follows:

- **Small, Minority, and Women-owned Business Investment:** 1.5 percent to a small, minority, and women-owned business investment account;
- **State Lottery:** 2.0 percent to the lottery for administrative costs, with other costs provided for in the annual State budget;
- **Local Impact Grants:** 5.5 percent to local governments where a video lottery facility is operating, 18.0 percent of which would go for 15 years (starting in fiscal 2012) to Baltimore City through the Pimlico Community Development Authority and to Prince George's County for the community surrounding Rosecroft (\$1 million annually);
- **Horse Racing Industry:** 7.0 percent to a purse dedication account to enhance horse racing purses and funds for the horse breeding industry, not to exceed \$100 million

annually; and 2.5 percent for an eight-year period to a Racetrack Facility Redevelopment Account, not to exceed \$40 million annually;

- **Licensee (Operator):** 33.0 percent to video lottery operation licensees; and
- **Education Trust Fund:** the remainder to the Education Trust Fund (48.5 to 51.0 percent).

Revenues accruing to the Education Trust Fund are to be used for the Bridge to Excellence in Public Schools Act funding (including the Geographic Cost of Education Index), public school construction funding, and public higher education construction, including community colleges.

Exhibit 2 details the revenue distributions resulting from VLTs for fiscal 2011 through 2013.

Exhibit 2
Distribution of VLT Revenues
Fiscal 2011-2013
(\$ in Millions)

	<u>2011</u>	<u>2012</u>	<u>2013</u>
Total Annual Gross	\$156.5	\$1019.1	1361.6
Education Trust Fund	75.9	494.3	660.4
Licenses	51.7	336.3	449.3
Purse Dedication Account	11.0	71.3	95.3
Local Impact Grants	8.6	56.0	74.9
Racetrack Renewal	3.9	25.5	34.0
Lottery Operations	3.1	20.4	27.2
Small, Minority, and Women-owned Business Investment	2.3	15.3	20.4

VLT: video lottery terminal

Source: Department of Legislative Services

VLTs in Surrounding States

Pennsylvania

Penn National Racetrack, located near Harrisburg, became the seventh VLT facility (six of which are located at racetracks) to commence operations in Pennsylvania since November 2006. Current law authorizes up to 14 VLT facility licenses and a maximum statewide total of 61,000 VLTs. Of the 14 licenses, 7 are reserved for racetracks, 5 are for nontrack locations, and 2 are for resort licenses. **Exhibit 3** lists the current facilities, the current number of VLTs at each facility, average win per day, and fiscal 2008 revenues (after payouts to bettors).

Exhibit 3
Pennsylvania VLT Facilities in Operation
as of November 2008
(\$ in Millions)

<u>Facility</u>	<u>Open Date</u>	<u>Revenue</u>	<u># of VLTs</u>	Fiscal 2008
				Average Win per Day
Mohegan Sun	November 2006	\$170.6	1,203	\$389
Philadelphia Park	December 2006	325.2	2,534	352
Chester Downs	January 2007	332.8	2,781	328
Presque Isle	February 2007	161.7	1,997	222
The Meadows	June 2007	231.2	1,783	355
Mt. Airy	October 2007	110.6	2,523	160
Penn National	February 2008	72.7	2,024	236
Total		\$1,404.8	14,845	\$285

VLT: video lottery terminal

Source: Pennsylvania Gaming Control Board

Of the five nontrack licenses awarded in December 2006 by the Pennsylvania Gaming Control Board, only Mt. Airy, located in the Poconos, is currently operating. Unexpected challenges causing delays for two of the potential facilities appear to have been solved, while several issues remain for two additional facilities in Philadelphia. Construction delays have pushed back the anticipated opening of the Sands Bethworks facility in Bethlehem to the second quarter of 2009. PITG Gaming announced last spring that construction delays and difficulties in

the credit market had forced it to restructure its financing and ownership interests for a VLT facility in Pittsburgh. Completion of that project is now expected in August 2009.

Although the Gaming Control Board awarded licenses for the Foxwoods and Sugarhouse VLT facilities to be located in South Philadelphia, opposition from the mayor and elected officials representing the area have at least temporarily blocked construction of the facilities. Foxwoods is currently in talks to relocate to the downtown area near Chinatown and Independence Hall. If an agreement is reached, it appears that an additional 18 months will be required to gain zoning and regulatory approvals and to complete construction. The Governor's Office recently announced its intention to initiate talks on relocating the Sugarhouse location to downtown as well. If an agreement is not reached, Sugarhouse could still opt to construct its facility in South Philadelphia, although city approval to build subsequent planned expansions appear to be lacking.

After the original applicants for the two available resort licenses withdrew their applications, the Gaming Control Board recently awarded one license to a resort located in King of Prussia, northwest of Philadelphia, and the other to a resort in the Poconos. The Gaming Control Board estimates that these facilities will likely begin operating in 2010.

Delaware and West Virginia

Total VLT revenues in Delaware and West Virginia declined in fiscal 2008, mainly due to increased competition from newly constructed Pennsylvania facilities. All four VLT facilities in West Virginia and two of the three VLT facilities in Delaware either lost revenue or were dependent on additional VLTs to generate revenue increases (Dover Downs was the exception). Even though the additional VLTs increased revenues, the increases were less than the magnitude of the expansion. For example, although Charles Town added about 700 machines (a 16 percent increase), revenues increased by less than 3 percent.

In 2008, the Mountaineer and Wheeling facilities in West Virginia expanded the number of table games offered to 87 and 73, respectively. Tri-State, the other West Virginia facility authorized to have table games, began installing table games in summer 2008 and now offers a total of 70 poker tables and other assorted gambling tables. The West Virginia Lottery Commission estimates that total table game revenue has averaged about \$1.7 million a week to date (a little less than \$100 million on an annual basis).

Exhibit 4 provides information on the number of VLTs and total net proceeds after payouts to gamblers at Delaware and West Virginia facilities in fiscal 2008.

Exhibit 4
Delaware and West Virginia VLT Facility Revenues
Fiscal 2008

	<u>Net Proceeds</u>	<u>Change over FY 2007</u>	<u>VLTs</u>	<u>Average Win per Day</u>
Delaware				
Delaware Park	\$271.9	-7.6%	3,137	\$237
Dover Downs	222.1	3.6%	2,688	226
Harrington	126.7	2.5%	1,652	210
Delaware Total	620.7	-1.8%	7,476	\$227
West Virginia				
Mountaineer	214.2	-13.5%	3,189	\$184
Wheeling Island	155.1	-22.0%	2,086	204
Tri-State	64.9	-0.5%	1,590	112
Charles Town	458.7	2.4%	5,019	250
West Virginia Total	\$892.9	-7.0%	11,884	\$206

VLT: video lottery terminal

Source: Delaware and West Virginia State Lotteries

Revenues and Taxes

Tax Compliance Measures

As it has done in past years, as part of a solution to balancing the State budget in difficult fiscal times, the General Assembly may seek to enhance tax revenue collections through measures to improve tax administration and enforcement and strengthen tax compliance.

Introduction

Notwithstanding the adoption during the 2007 special session of tax rate increases and significant structural changes for several major State taxes estimated to provide over \$900 million annually in additional general fund revenues, the State continues to face a fiscal crisis due to revenue shortfalls resulting from the recent national economic downturn and continued spending pressures.

During prior fiscal crises in the early 1990s and earlier this decade, the State budget was balanced in part through revenue enhancements from various “tax compliance” measures. These measures were designed to enhance revenue collections from existing taxes without imposing new taxes or raising tax rates. In light of the fiscal challenges facing the State, the General Assembly may again seek to enhance State revenue collections through enactment of additional tax compliance measures.

Although a myriad of tax compliance measures have been enacted over the years, most of the ones that have been used in the past to enhance revenues have generally fallen into one of the following categories:

- vendor collection credits and discounts;
- tax clearance requirements;
- payment of taxes in immediately available funds (*i.e.*, electronic funds transfers); and
- tax withholding/estimated taxes/tax collection provisions.

Vendor Collection Credits and Discounts

Prior to 1992, vendors were allowed a credit equal to 1.2 percent of the gross sales and use tax owed for the expense of collecting and paying over the tax to the Comptroller. Under budget financing legislation enacted in 1992, the vendor collection credit was reduced to 0.6 percent for amounts in excess of \$4,200 in gross sales tax owed for each return. In 1994, the

threshold for application of the lower rate was increased from \$4,200 to \$6,000 and the applicable percentage for amounts above the threshold was increased from 0.6 to 0.9 percent.

The vendor collection credit has been a popular provision in budget reconciliation and financing legislation during this decade. In 2002, the sales tax vendor collection credit and a similar vendor collection credit under the motor vehicle excise tax were reduced by 50 percent for fiscal 2003 and 2004 only. In 2004, the temporary reduction in the vendor credit under the sales and use tax (but not under the motor vehicle excise tax), was extended for two more years through fiscal 2006. In 2005, the vendor credit was eliminated for use tax payments made by a vendor related to the vendor's own purchases. The temporary 50 percent reduction in the sales tax vendor credit was allowed to expire at the end of fiscal 2006. However, legislation passed in the 2007 special session again temporarily reduced the credit for large vendors by imposing a \$500 per-return maximum on the credit through fiscal 2011.

Recent proposals regarding vendor credits and discounts include repealing the vendor collection credit under the sales and use tax entirely, which is estimated to generate approximately \$15 million to \$20 million annually, in additional State tax revenues.

Tax Clearance Requirements

The 1992 budget financing legislation established "tax clearance" requirements (*i.e.*, ensuring that all undisputed taxes have been paid) for State contractors and certain business license and permit applicants. For specified licenses and permits, applicants were required to certify their own tax compliance to the issuing authority. For State procurements of \$10,000 or more, bidders or offerors were required to certify tax compliance to the procuring agency. For procurements of \$100,000 or more, the legislation required the procuring unit to verify, through the Comptroller, the tax clearance of the bidder or offeror before awarding the contract.

In 2003, the tax clearance provisions regarding licenses and permits were enhanced to require the issuing agency to verify the applicant's tax clearance, through the Comptroller, before issuing or renewing a license. In 2005, the tax clearance requirements were expanded to include insurance business licenses and legislation passed in the 2007 special session and amended in 2008 provides for a form of tax clearance for lawyers.

Under current law, the tax clearance requirements do not apply to the issuance or renewal of vehicle registrations or driver's licenses. Recent proposals have been made to extend the tax clearance requirements to these areas, with increased compliance expected to generate additional revenues of up to \$10 million annually.

Payment of Taxes in Immediately Available Funds

The 1992 budget financing legislation authorized the Comptroller and the State Department of Assessments and Taxation to require taxpayers to pay taxes in funds that are immediately available to the State (*i.e.*, by electronic funds transfer), if at least \$20,000 is owed in connection with a return or other document required to be filed. In addition, the legislation authorized the Comptroller to provide for payment in immediately available funds of any delinquent unpaid tax liability for withholding taxes, corporate income tax, or sales and use tax. In 2003, the threshold for authority to require electronic funds transfers for non-delinquent tax payments was reduced from \$20,000 to \$10,000.

Reducing the threshold for applicability of the electronic funds transfer requirement from \$10,000 to \$5,000 would further accelerate the State's receipt of funds and reduce processing costs, generating an estimated \$500,000 annually in revenues.

Withholding/Estimated Tax Payment/Tax Collection Provisions

Numerous measures requiring the withholding of taxes under various circumstances or enhancing withholding, estimated tax payment, enhancement of collection enforcement, and related provisions were enacted from 2003 through 2005. These provisions include the elimination of graduated income tax rates from the calculation of the amount employers are required to withhold from employee wages and the addition of withholding requirements for sales of real property by nonresidents, payments to nonresident contractors (later repealed), and payment of racetrack winnings. In addition, various provisions were enacted to accelerate tax payments to the State, including an accelerated payment schedule for vendor payment of withholding taxes by large employers and advancing the due date for payment of the sales and use tax.

Recent proposals in this area include the elimination of the standard deduction from the employer withholding calculation, requiring withholding for real property sales by residents under certain circumstances, and requiring large retailers to make estimated payments of sales and use tax. Other recent suggestions include requiring employers in the State to file a use tax return annually, even if the employer is not a licensed sales tax vendor, and expanding the reciprocal federal vendor offset program to allow salaries and retirement benefits to be included in the program.

Personnel

State Retirement and Pension System Investment Performance and Contribution Rates

Total State pension contribution rates are projected to increase by more than 13.0 percent in fiscal 2010, resulting in over \$1.2 billion in contributions. For the first time in six years, the system's investments experienced negative returns, reducing the funded status from 80.4 to 78.6 percent. After the fiscal 2009 budget was introduced in January 2008, an \$88 million actuarial error was discovered. Because this underpayment is not recognized on the pension fund's financial statement until June 30, 2009, the fiscal 2010 rate does not reflect any correction. This error can be corrected with a full or partial payment in fiscal 2010 or by amortizing the error over 25 years.

Actuarial Error Contributes to Increase in State Pension Contribution Rates

Total State pension contribution rates will increase by more than 13.0 percent over budgeted fiscal 2009 rates. The fiscal 2009 budgeted rates were below the final rates certified by the State Retirement and Pension System board of trustees due to an actuarial error that was discovered in January 2008 but not corrected in time to adjust the budgeted rates. By comparison, the fiscal 2010 rates are just 4.0 percent higher than the final certified rates for fiscal 2009. Also, for the first time in six years, the State Retirement and Pension System (SRPS) experienced negative investment returns, with its portfolio returning -5.4 percent. As a result, the system's funded status (the ratio of projected assets to projected liabilities) dropped from 80.4 to 78.6 percent.

In January 2008, the SRPS board of trustees notified the Governor and the General Assembly that its actuary had uncovered an error in the calculation of the pension contribution rates the board had certified that fall. The error involved a glitch in the computer software used to calculate the rates and was uncovered in the course of responding to questions about the rates that the actuary had received from members of the board. After completing an external audit by a different actuary, the board certified corrected higher rates in March 2008, but it was too late to include the new rates in the legislative appropriation approved during the legislative session. Most of the increase in contribution rates from fiscal 2009 to 2010 reflects the gap between the original rates included in the fiscal 2009 State budget and the corrected rates certified by the board in March.

Exhibit 1 shows that the employer contribution rate for teachers will increase from 11.70 percent in fiscal 2009 to 13.15 percent in fiscal 2010, and the contribution rate for State employees will increase from 8.73 percent in fiscal 2009 to 9.93 percent in fiscal 2010. The aggregate State contribution rate, including contributions for law enforcement officers and judges, increases from 11.14 percent in fiscal 2009 to 12.62 percent in fiscal 2010. Based on projected payroll growth, the SRPS actuary estimates that total State pension contributions will

increase by \$202.8 million, from \$1,030.6 million in fiscal 2009 to \$1,233.4 million in fiscal 2010.

Exhibit 1
State Pension Contribution Rates
Fiscal 2009 and 2010
(\$ in Millions)

<u>Plan</u>	<u>FY 2009</u>		<u>FY 2010</u>	
	<u>Rate</u>	<u>Contribution</u>	<u>Rate</u>	<u>Contribution</u>
Teachers	11.70% (12.92)	\$691.4	13.15%	\$832.6
Employees	8.73% (9.01)	273.1	9.93%	319.7
State Police	20.53% (25.27)	17.7	30.79%	27.5
Judges	43.61% (44.09)	17.0	48.89%	19.2
Law Enforcement Officers	36.99% (39.90)	31.4	38.63%	34.3
Aggregate	11.14% (12.09)	\$1,030.6	12.62%	\$1,233.4

Note: For fiscal 2009, budgeted rates and contributions are provided. Corrected contribution rates are in parentheses. Contribution rates reflect State funds only, excluding municipal contributions.

Source: Cheiron, Segal Co.

Negative Returns Not Forcing Up Contribution Rates...Yet

SRPS investments returned -5.4 percent in fiscal 2008, due largely to significant declines in both the domestic and international public equity markets. Total system assets fell from an all-time high of \$39.4 billion at the end of fiscal 2007 to \$36.6 billion at the end of fiscal 2008. However, due to asset smoothing strategies used by the system's actuary, the full effects of the negative returns are not being felt on contribution rates.

When investment returns exceed the actuarial target of 7.75 percent, they create an actuarial surplus that can exert downward pressure on State pension contributions in future years, assuming that the plan's actual experience conforms to other actuarial assumptions. To protect the system from sharp spikes in investment returns in any given year, the system's actuary uses a smoothing mechanism that spreads out investment returns or losses over five years. This smoothing mechanism yields an actuarial rate of return, which represents the five-year average return. Because SRPS investments experienced four straight years of investment returns that exceeded the actuarial target, the actuarial rate of return (9.7 percent) exceeds the system's actuarial target for the second straight year. As a result, the pension fund's investment performance was not a factor in the contribution increases experienced this year. However, if the

current turmoil in the financial markets results in significant investment losses at the end of fiscal 2009, it is likely that the actuarial rate of return will drop below the target and exert further upward pressure on contribution rates.

\$88 Million Needed to Correct the Actuarial Error

The actuarial error that occurred during the calculation of the fiscal 2009 State contribution rates resulted in an \$88 million underpayment by the State for employee and teacher pensions. Although the 2010 contribution rates are correct, they do not include any contribution toward repaying that amount. In fact, the underpayment is not recognized on the pension fund's financial statements until June 30, 2009, so it had no bearing on the calculation of the fiscal 2010 rates.

The State faces several options for repaying the \$88 million to the pension fund. The first option is to include a lump-sum payment of \$88 million to SRPS in either the fiscal 2010 or 2011 budget, thereby avoiding the accrual of interest on the unpaid portion. The second option is to withhold repayment, thereby allowing the underpayment to appear as an additional unfunded liability during the calculation of the fiscal 2011 contribution rates. This will result in the underpayment being amortized over 25 years, along with the rest of the pension fund's unfunded liabilities. The State Retirement Agency estimates that the amortization payment will add approximately \$6 million to the State's contribution in fiscal 2011. Alternatively, the State could pay a portion of the underpayment in a lump-sum payment and allow the remainder to be amortized.

Personnel

State Workforce and Payroll

Since fiscal 2002, the number of State positions has increased from 81,009 to 81,264. Declines in the Executive Branch positions were offset by increases in higher education, judicial, and legislative positions. In response to reductions in projected revenues, the Board of Public Works deleted 802 vacant and 40 filled positions in June and October 2008. Personnel costs increased by 41 percent from fiscal 2002 to 2009. Salary costs increased 35 percent, State health care subsidies increased 77 percent, and retirement contributions increased 80 percent.

Budgeted Positions

Regular Positions

Budget spending limits, position caps restricting growth, closure of State institutions, attrition, and abolitions prompted by budgetary constraints have decreased the nonhigher education Executive Branch workforce from 56,417 full-time equivalent (FTE) positions in fiscal 2002 to 52,951 in the fiscal 2009 working appropriation. As of November 1, 2008, the total State workforce consisted of 81,264 regular FTE positions.

Exhibit 1 shows that three major agencies represent 90 percent of the net decrease in the Executive Branch: the Department of Human Resources, the Department of Health and Mental Hygiene, and the Maryland Department of Transportation. These reductions, however, have been offset by new positions created in higher education institutions, the Judicial Branch, the Department of Public Safety and Correctional Services, and legal agencies (primarily, the Office of the Public Defender).

Exhibit 1
Regular Full-time Equivalent Employees
Fiscal 2002 Legislative Appropriation and Fiscal 2009 Working Appropriation

<u>Department/Service Area</u>	<u>2002 Fiscal Digest</u>	<u>2009 Working Approp. (11/08)</u>	<u>2002-2009 Change</u>	<u>2002-2009 % Change</u>
Health and Human Services				
Health and Mental Hygiene	8,552	7,237	-1,315	-15.4%
Human Resources	8,288	6,849	-1,438	-17.4%
Juvenile Services	2,123	2,272	149	7.0%
Subtotal	18,962	16,358	-2,604	-13.7%
Public Safety				
Public Safety and Correctional Services	11,163	11,676	513	4.6%
Police and Fire Marshal	2,590	2,441	-149	-5.8%
Subtotal	13,752	14,116	364	2.6%
Transportation	9,551	9,135	-417	-4.4%
Other Executive				
Legal (excluding judiciary)	1,368	1,571	203	14.9%
Executive and Administrative Control	1,606	1,657	51	3.2%
Financial and Revenue Administration	2,168	1,995	-174	-8.0%
Budget and Management	517	445	-72	-13.9%
Retirement	193.5	203	10	4.9%
General Services	725	611	-114	-15.7%
Natural Resources	1,631	1,358	-274	-16.8%
Agriculture	480	427	-54	-11.1%
Labor, Licensing, and Regulation	1,706	1,450	-256	-15.0%
MSDE and Other Education	1,950	2,144	194	10.0%
Housing and Community Development	450	311	-139	-30.9%
Business and Economic Development	323	260	-63	-19.5%
Environment	1,034	912	-122	-11.8%
Subtotal	14,151	13,342	-809	-5.7%
Executive Branch Subtotal	56,417	52,951	-3,466	-6.1%
Higher Education	20,843	23,997	3,155	15.1%
Judiciary	3,021	3,569	549	18.2%
Legislature	729	747	18	2.5%
Grand Total	81,009	81,264	255	0.3%

MSDE: Maryland State Department of Education

Source: Department of Budget and Management; Department of Legislative Services

Fiscal 2009 Abolitions

Two Board of Public Works' actions, one in June 2008 and the other one in October 2008, contributed an equivalent of more than 24 percent of the net reduction in Executive Branch position levels seen since fiscal 2002. The fiscal 2009 budgeted FTE count was lowered by a total of 842 positions between the Administration's two reductions. Of these abolitions, 40 represented filled positions while 802 were vacant. **Exhibit 2** shows the positions abolished by department.

Exhibit 2 June 25 and October 15, 2008 Board of Public Works Position Reductions

<u>General Funds Positions</u>	Position Reduction	
	<u>Vacant</u>	<u>Filled</u>
Office of the Public Defender	17.00	0.00
Office of the Attorney General	2.00	0.00
Executive Department-Boards and Commissions	2.00	2.00
Commission on Human Relations	3.00	0.00
Maryland Department of Planning	10.00	0.00
Military Department	6.00	0.00
State Department of Assessments and Taxation	41.00	0.00
Comptroller of Maryland	10.00	0.00
Department of Budget and Management	4.00	0.00
Department of General Services	27.00	0.00
Department of Natural Resources	44.00	2.00
Maryland Department of Agriculture	10.00	0.00
Department of Health and Mental Hygiene	189.65	4.00
Department of Human Resources	100.00	6.00
Department of Labor, Licensing and Regulation	10.00	1.00
Department of Public Safety and Correctional Services	161.00	0.00
Maryland State Department of Education	35.00	0.00
Maryland Higher Education Commission	4.00	0.00
Department of Business and Economic Development	12.00	3.00
Maryland Department of the Environment	20.00	0.00
Department of Juvenile Services	25.00	0.00
Department of State Police	25.00	0.00
General Fund Subtotal	757.65	18.00
<u>Special Funds Positions</u>		
Maryland Department of Transportation	44.00	22.00
Total Reductions	801.65	40.00

Source: Department of Budget and Management; Department of Legislative Services

Higher Education

Chapters 239 and 273 of 2004 provide the University System of Maryland (USM) and Morgan State University with autonomy from the General Assembly to establish staffing levels absent specific legislative constraints, as did Chapter 401 of 2003 for St. Mary's College. By the end of October 2008, the fiscal 2009 impact of these bills was the addition of 276 FTE positions to higher education facilities, all of which originated in USM.

Regular Position Compensation Expenditures

The budgeted expenditure for salaries grew to \$4.43 billion in fiscal 2009, a 28.2 percent total increase from the actual level of salaries in fiscal 2002, as is shown in **Exhibit 3**. The portion of the growth in State employee salaries attributable to general salary increases, commonly referred to as cost-of-living adjustments, represents 9.4 percent of the total, with the balance stemming from merit increases, hiring actions such as reclassifications, and changes in the composition of the workforce.

Exhibit 3
Regular Employee Compensation
Fiscal 2002 Actual to Fiscal 2009 Working Appropriation
(\$ in Millions)

	<u>2002 Actual</u>	<u>2009 Working Appr.</u>	<u>2002-2009 \$ Change</u>	<u>2002-2009 % Change</u>
Earnings				
Salary	\$3,458.0	\$4,433.6	\$975.7	28.21%
Other Earnings ¹	113.2	126.6	13.4	11.84%
Earnings Subtotal	\$3,571.1	\$4,560.2	\$989.1	
Other Compensation				
Health ²	\$486.7	\$863.3	\$376.7	77.39%
Retirement/Pensions ³	239.9	410.8	170.9	71.24%
Salary-dependent Fringe	258.6	326.8	68.2	26.37%
Agency-related Fringe	99.5	109.2	9.6	9.68%
Other Compensation Subtotal	\$1,084.7	\$1,710.1	\$625.4	
Total Compensation	\$4,655.8	\$6,270.3	\$1,614.5	34.68%

GSI: General Salary Increase

¹Other Earnings: Overtime and Shift Differentials

²Health: Employee and Retiree Health Insurance

³Retirement/Pensions: All Pension/Retirement Systems

Source: Department of Budget and Management; Department of Legislative Services

The State subsidy for employee and retiree health insurance was the fringe benefit area posting the largest growth, as it has increased by \$376.7 million, or 77.4 percent, since fiscal 2002. Several years of double-digit percent increases on the cost side caused the majority of this growth. Retirement contributions made by the State have grown by 71.2 percent since fiscal 2002, making it the area of employee compensation with the second largest percent increase over the time period. The increase is primarily due to enhancements enacted in 2006 that raised the benefit multiplier.

Retiree Health Care Liabilities

Beginning in fiscal 2008, new accounting standards require the State to account for liabilities associated with State employee retiree health care on its annual financial statements. The most recent valuation indicated that the State's retiree health liabilities total \$15.2 billion. Compliance with the new standards would require the State to contribute \$1.2 billion each year toward funding these liabilities. A Blue Ribbon Commission has been charged with making recommendations on how to address this significant fiscal challenge. The commission is required to complete its review and recommendations by December 31, 2009.

Background

Chapter 433 of 2006 established the Blue Ribbon Commission to Study Retiree Health Care Funding Options. The membership of the commission includes legislators, elected officials and appointees of the Executive Branch, and members of the public with expertise in either funding retiree health benefits, the economics of affordable retiree health care programs, or investing pension fund assets.

Chapter 433 directs the commission to contract with an actuarial consulting firm that will conduct an annual actuarial valuation of the liabilities associated with Government Accounting Standards Board (GASB) Statement 45 and provide ongoing services to the commission throughout its existence of two years. Additionally, Chapter 433 charged the commission with several duties including:

- reviewing the State's legal obligation to provide retiree health benefits;
- studying the factors contributing to the rising cost of retiree health benefits;
- reviewing current benefit levels for State employees and retirees;
- reviewing the eligibility requirements for retiree health benefits; and
- reviewing alternatives for providing health benefits to State retirees.

The standards of GASB 45 require governmental employers to account for liabilities associated with the employers' commitment to what is referred to as Other Post Employment Benefits (OPEB), such as retiree health insurance. Under GASB 45 standards, Maryland is now required to account for these OPEB liabilities. The benefits to be valued for the purposes of OPEB liabilities are the retiree health benefits, as understood by the State and the employees. The financial reporting under GASB 45 provides that employers must commission an actuarial valuation of OPEB liabilities every two years. Once a valuation is done, an annual required contribution (ARC) amount will be calculated, that represents the annual payment by the

employer that would be necessary to fund the normal costs accrued for that year (liability for current and future benefits earned by employees in that year), in addition to an amount that represents the amortization of any unfunded OPEB liabilities (benefits earned to the date of the valuation).

Update on Blue Ribbon Commission

At the September 2007 meeting of the commission, members were assigned to three workgroups – benefits, finance, and legal. In light of the special session during October and November 2007, the workgroups did not meet until December 2007. The members of the benefits workgroup discussed and reviewed options for restructuring health care benefits for current and future members. The benefits workgroup requested that Buck Consulting Firm analyze the potential savings from various hypothetical benefit changes that would affect future retirees only. These changes included:

- raising the minimum number of years of active service that a retiree must accrue before becoming eligible for retiree health benefits;
- raising the minimum number of years of active service that an employee must accrue before being eligible for the maximum retiree premium subsidy;
- reducing the premium subsidy available to spouses of retirees from 80 to 60 percent; and
- eliminating the additional subsidy provided to retirees who also cover a spouse in the State's prescription drug plan.

The finance workgroup discussed options for financing health care benefits for current and future State retirees. The members received a presentation by the Buck Consulting Firm, summarizing the advantages and disadvantages of accepting the Retiree Drug Subsidy provided under Medicare Part D. The members also identified alternative funding sources and vehicles for financing the State's retiree health care benefits, including financing the benefits through OPEB bonds.

The legal workgroup received a briefing from representatives of the Attorney General's Office on the legal obligations the State may face with respect to health care benefits for State employees and retirees. A significant portion of the briefing was spent distinguishing why State law creates a contractual obligation for the State to provide State employees a pension and no such obligation exists for health care benefits. The representatives from the Attorney General's Office concluded that because of these differences, the General Assembly is not restricted from modifying the current health care benefits provided to both State employees and retirees, as it would be if it attempted to amend the plan provisions for the State Retirement and Pension System.

At each of the workgroup meetings, the members of the commission also received the results of the June 30, 2007 actuarial valuation of the State's retiree health liabilities from the Buck Consulting Firm. It was reported that the State's unfunded retiree health liabilities increased from \$14.5 billion in fiscal 2006 to \$15.2 billion in fiscal 2007, with the State's ARC increasing from \$1.1 billion in fiscal 2006 to \$1.2 billion in fiscal 2007. In addition, the Buck Consulting Firm noted that prescription drug coverage for current and future Medicare-eligible retirees and spouses represented 53 percent of the State's unfunded retiree health liabilities.

2008 Session and Interim

The 2007 special session precluded the commission from meeting as often as they had originally planned in fall 2007. As a result, legislation was adopted during the 2008 session to extend the commission's duration from December 31, 2008, to December 31, 2009. Chapters 228 and 229 of 2008 also require the commission to issue an interim report by December 31, 2008, stating its findings up to that time.

The fiscal 2007 and 2008 budgets, as adopted, each directed \$100 million to the Dedicated Purpose Account to begin prefunding the State's retiree health care liability. During the 2008 session, the General Assembly appropriated \$100 million of these funds to the general fund, resulting in \$100 million being sent to the OPEB trust in June 2008.

Beginning in fiscal 2008, proceeds from the Medicare Part D subsidy, approximately \$20 million per year, are also utilized to offset the OPEB liability.

The Governor's fiscal 2009 allowance included \$210 million in payroll-based contributions. However, to balance the budget, the General Assembly reduced the appropriation to \$106 million. In October 2008, the Board of Public Works further reduced the fiscal 2009 appropriation by \$46.1 million in general funds, but the effect will be a reduction of approximately \$82.4 million once other funds sources follow suit, resulting in approximately \$23.6 million being appropriated in fiscal 2009 to prefund the OPEB liability.

The commission resumed meeting in September 2008. At that meeting, the full commission received updates from each of the workgroups, Buck Consulting Firm's analysis of various benefit redesign options, and a presentation on OPEB financing. In addition to issuing an interim report by December 31, 2008, it is expected that the commission will continue to meet during the 2008 interim and throughout the 2009 interim to consider benefit design options that reduce State liabilities and ARCs.

Education

Moderate Increase in State Education Aid Projected for Fiscal 2010

In fiscal 2010, increases in direct State aid for public primary and secondary education will be constrained for a second consecutive year. Although a \$216 million increase in State funding is projected, \$134 million is attributable to the increase in teachers' retirement costs, which are paid by the State but do not go directly to local school systems. Further, most of the projected \$82 million growth in direct State aid for local school systems is due to an expected increase in the discretionary geographic cost of education index, which may be optimistic given the State's worsening fiscal outlook.

State Education Funding Projected to Increase by \$216 Million

State aid for public schools is estimated at \$5.6 billion for fiscal 2010, representing a \$215.9 million (4.0 percent) increase over the prior year. The projected growth is slightly higher than the increase from fiscal 2008 to 2009 and is the third smallest increase since the implementation of the Bridge to Excellence in Public Schools Act of 2002. The additional funds include \$82.2 million in funds provided directly to local school boards, bringing direct State aid up from \$4.73 billion to \$4.81 billion, a 1.7 percent increase. As expected, the increase in direct aid is lower than it has been in recent years due to the completion of the Bridge to Excellence phase-in in fiscal 2008 and cost containment actions taken at the 2007 special session. In contrast, teachers' retirement costs, which are paid by the State on behalf of the local school systems, will increase by \$133.7 million from \$621.8 million to \$755.5 million, a 21.5 percent increase. **Exhibit 1** illustrates the annual changes in State education aid from fiscal 2003 to 2010.

Several Large Direct Aid Programs Expecting Little or No Growth

Fiscal 2010 is the second year direct State aid to local school systems will be constrained by the freeze in the per pupil foundation amount enacted by the 2007 Budget Reconciliation Act (Chapter 2 of the 2007 special session). As shown in **Exhibit 2**, funding for the foundation program is projected to decrease by \$12.6 million from the fiscal 2009 appropriation. With a stable per pupil funding level, the 0.5 percent decrease in foundation aid is due to the projected drop in full-time equivalent student enrollment from 815,742 to 811,363 students. The per pupil foundation amount is also used to calculate aid under three other large State aid formulas (the compensatory education, special education, and limited English proficiency formulas), meaning changes in the funding for these formulas will be limited to changes in the at-risk student enrollments used in the formulas. Beginning in fiscal 2011, the per pupil amount will again increase with inflation.

Exhibit 1
Annual Increases in State Education Aid
Fiscal 2003-2010
(\$ in Millions)

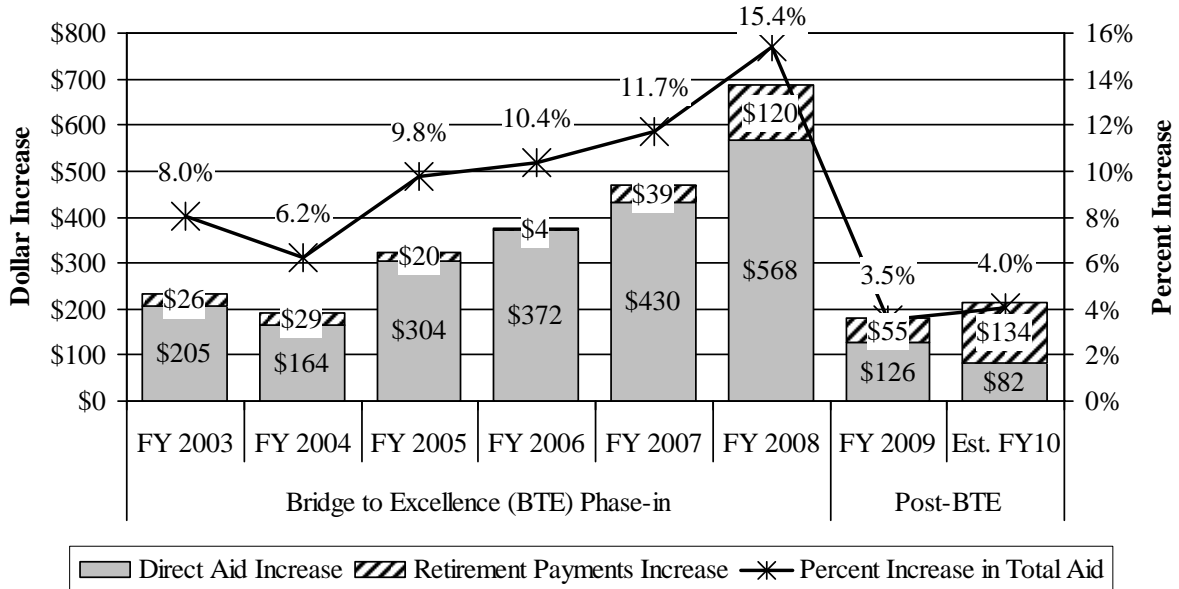


Exhibit 2
Estimated State Aid for Education
Fiscal 2010
(\$ in Millions)

<u>Program</u>	<u>FY 2009</u>	<u>FY 2010</u>	<u>Dollar Change</u>	<u>Percent Change</u>
Foundation Program	\$2,756.8	\$2,744.2	(\$12.6)	(0.5%)
Geographic Cost of Education Index	75.8	125.1	49.3	65.1%
Supplemental Grants	36.6	36.5	(0.2)	(0.5%)
Compensatory Education	914.4	915.0	0.6	0.1%
Special Education Formula	272.7	271.0	(1.7)	(0.6%)
Limited English Proficiency	143.9	154.6	10.7	7.4%
Guaranteed Tax Base	89.9	100.4	10.5	11.7%
Student Transportation	225.1	241.4	16.3	7.2%
Nonpublic Special Education	127.6	132.8	5.2	4.1%
Other Programs	84.9	89.0	4.1	4.9%
Direct Aid Subtotal	\$4,727.7	\$4,809.9	\$82.2	1.7%
Teachers' Retirement	621.8	755.5	133.7	21.5%
Total	\$5,349.5	\$5,565.4	\$215.9	4.0%

To mitigate the impact of the two-year freeze in the per pupil foundation amount, the Budget Reconciliation Act established supplemental grants that ensure at least a 1 percent annual increase in State funding for each local school system in fiscal 2010 in accordance with a formula for the grants codified in the legislation. A school system will receive a supplemental grant if State aid calculations for the system through the other formulas (including 50 percent of the State's teachers' retirement contribution and 60 percent of geographic cost of education index funding) result in less than a 1 percent increase in funding from fiscal 2009 to 2010. Supplemental grants are projected to be \$36.5 million in fiscal 2010, a \$182,000 (0.5 percent) decrease from fiscal 2009.

Estimates Assume Full Funding for Cost of Education Index

The largest direct aid increase, \$49.3 million, is projected for the geographic cost of education index (GCEI). The estimated increase assumes that the GCEI formula will phase up from 60 percent funding in fiscal 2009 to 100 percent funding in fiscal 2010, as negotiated at the 2007 special session. However, the GCEI's status as a discretionary aid program and the State's worsening fiscal condition may jeopardize full funding for the GCEI formula in fiscal 2010. If the phase-in level for the GCEI remains at 60 percent in fiscal 2010, there would be a slight decline in State funding for the formula due to the projected dip in student enrollment. This would also have an impact on the calculation of the supplemental grants since a portion of the GCEI funding is used in the calculation of the 1 percent guarantee. With a lower funding level for the GCEI, more school systems could fall below the required 1 percent increase and, therefore, qualify for supplemental grants. Other systems may require larger supplemental grants to compensate for the lower levels of GCEI aid.

Increases in Retirement Costs Dominate Growth in Fiscal 2010 Education Aid

Teachers' retirement costs, which the State pays on behalf of local school systems, comprise 61.9 percent of the projected growth in State education aid for fiscal 2010, easily the largest dollar increase among the education aid programs. Because retirement costs are factored into the calculation of supplemental grants, the large increase will also diminish the amount of direct aid needed to reach the guaranteed 1 percent increase.

The \$133.7 million (21.5 percent) escalation in retirement costs is due to an 8.1 percent increase in the total salary base of professional public school personnel and an increase in the State's contribution rate from 11.7 percent in fiscal 2009 to 13.15 percent in fiscal 2010. With a funding level of \$755.5 million in fiscal 2010, teachers' retirement costs will have increased by an average of 19.2 percent per year and by more than \$300 million since fiscal 2007. Annual increases of \$60 million to \$100 million in retirement costs are anticipated beyond fiscal 2010, meaning State funding for retirement will continue to have a significant impact on State education aid for years to come.

Education

Most High School Seniors Have Met High School Assessment Requirements to Graduate

After 15 years of development and debate, the 2008-2009 academic year marks the first year that meeting minimum High School Assessment (HSA) standards will be required for graduating seniors throughout the State. Over the past two years, following a series of public hearings and continued study by the State Board of Education, the board amended the requirements to allow qualifying students to complete project-based assessments or qualify for graduation by reaching a minimum combined score on the exams. Of the 54,628 students who are required to complete the requirements and are otherwise on schedule to graduate this year, there were 9,059 students who had not met HSA graduation requirements as of October 2008.

Bridge Plan Offers Alternative to HSAs

The Maryland High School Assessments (HSAs) consist of four end-of-course tests designed to measure school and individual student academic performance in English, algebra/data analysis, biology, and government. Statewide planning and development of the HSAs began nearly 15 years ago with the goal of raising high school standards and replacing the Maryland Functional Tests, which were being used at the time as a requirement for high school graduation. After years of development, HSAs were field tested in 2000 and 2001, and students' scores began to appear on high school transcripts in 2002. In 2004, the State Board of Education voted to make passage of the HSAs a graduation requirement beginning with students entering ninth grade in fall 2005 (the class of 2009).

In October 2007, after a significant amount of additional study and discussion, including five public hearings held throughout the State, the State board voted 8-4 to retain the HSAs as a graduation requirement. In the process of reviewing the HSAs, the State board made two modifications to the policies that had been in place. The board approved the Bridge Plan for Academic Validation, thus providing a student who is unable to pass the HSAs with the option of completing one or more subject-based projects in lieu of passing the assessments. The board also altered the minimum score requirement. Previously, a student was eligible for graduation with a qualifying combined score on the four tests as long as a minimum score on each test was achieved. The qualifying combined score option was retained but with no minimum required scores for individual tests.

State Board Reaffirms HSAs as Graduation Requirement

Responding to concerns raised about requiring success on the HSA for the class of 2009, the State board revisited the issue in October 2008. The board again heard from the public, including individuals who testified in favor of retaining the board's HSA standards and those wishing to delay or eliminate the requirements. The biggest concern voiced by those opposed to using HSAs as a graduation requirement was that students with disabilities and students with limited English proficiency, who otherwise would qualify for graduation, will not be able to complete the exam requirements by June 2009. Those in favor of maintaining the requirement believe that the HSA exams will set a clear minimum competency level for recipients of a Maryland high school diploma. In addition to testimony from the general public, the State board heard testimony from local superintendents of schools, the majority of whom spoke in favor of keeping in place the HSA requirements for the class of 2009.

After a lengthy discussion, the board voted 7-4, with one member absent, to maintain the existing HSA graduation requirements. However, the board is scheduled to adopt an appeals process for students with extenuating circumstances at its December 2008 meeting.

83 Percent of the Class of 2009 Has Met HSA Requirements

Currently, there are 54,628 students who are required to complete the HSA requirements and are otherwise on pace to graduate in June 2009. Of the total, 45,569 students (83.4 percent) have already taken and passed all four exams or met the requirement by reaching the combined minimum score. Another 4,970 students (9.1 percent) have taken all four exams but have not achieved passing scores on all four or the minimum combined score option. These students have begun to work on their bridge plan projects. The number of projects a student must complete depends on how close the student is to completing the HSA requirements. A total of 3,695 students are relatively close to meeting the requirements and only need to complete between 1 and 5 projects each; 1,176 students need to complete between 6 and 14 projects; and 99 students need to complete 15 or more projects to fulfill the HSA requirement.

In addition to those students who have taken all four exams, there are 4,089 students (7.5 percent) statewide who have yet to take one or more of the HSAs. Of these, 1,758 are missing one or two exams and will most likely reach at least the minimum combined score. Another 1,059 are missing one or two exams but will likely need to complete a bridge project to meet the HSA requirements. The remaining 1,276 students (2.3 percent of the total) have not taken three or more exams. HSA exams are offered four times per year, with two more testing opportunities before June 2009. A third test administration will take place in June and allow for summer 2009 graduation.

The number of students in each county who had and had not met HSA requirements by mid-October 2008 is shown in **Exhibit 1**. Baltimore City and Prince George's County have the highest percentages, 35.0 and 35.5 percent, respectively, of students who have not yet met the

requirements. Prince George's County also has the highest number of students at risk of not receiving a high school diploma, followed by Montgomery and Baltimore counties and Baltimore City.

Exhibit 1
Students' High School Assessment Status by County

<u>County</u>	<u>All Students Eligible for 2009 Graduation</u>	<u>Students Meeting Requirement</u>	<u>Students Not Meeting Requirement</u>	<u>Percent Not Meeting Requirement</u>
Allegany	714	611	103	14.4%
Anne Arundel	4,322	3,968	354	8.2%
Baltimore City	3,396	2,206	1,190	35.0%
Baltimore County	7,039	5,958	1,081	15.4%
Calvert	1,324	1,249	75	5.7%
Caroline	374	327	47	12.6%
Carroll	2,183	2,078	105	4.8%
Cecil	1,059	953	106	10.0%
Charles	1,992	1,766	226	11.3%
Dorchester	279	245	34	12.2%
Frederick	2,858	2,678	180	6.3%
Garrett	367	323	44	12.0%
Harford	2,659	2,469	190	7.1%
Howard	3,583	3,329	254	7.1%
Kent	169	128	41	24.3%
Montgomery	9,959	8,143	1,816	18.2%
Prince George's	7,330	4,731	2,599	35.5%
Queen Anne's	579	537	42	7.3%
St. Mary's	1,040	933	107	10.3%
Somerset	143	125	18	12.6%
Talbot	345	281	64	18.6%
Washington	1,537	1,425	112	7.3%
Wicomico	861	649	212	24.6%
Worcester	516	457	59	11.4%
State	54,628	45,569	9,059	16.6%

Source: Maryland State Department of Education

Education

Comprehensive Master Plans Currently Scheduled to Continue After 2010

At the 2007 session, the General Assembly passed legislation to continue indefinitely the comprehensive master plan process that was put into place by the Bridge to Excellence in Public Schools Act of 2002. Because the evaluation of the Bridge to Excellence Act would not be completed until December 2008, the General Assembly also included language in the 2007 legislation that requires a review of this decision and the comprehensive master plan process at the 2009 session. Interim reports from the contractual Bridge to Excellence evaluators suggest that, although some modifications to the master planning process may be warranted, strategic planning has been critical to the success of Maryland students.

General Assembly Required to Revisit Master Plan Requirement

Chapter 652 of 2007 requires the General Assembly to review, during the 2009 session, the evaluation of the Bridge to Excellence in Public Schools Act of 2002 to determine whether:

- the comprehensive master plan requirement for local school systems could be differentiated to reflect differing levels of progress in improving student achievement;
- preexisting comprehensive plans could satisfy the master plan requirement; and
- local school systems could use preexisting comprehensive plans, if they are determined to satisfy the master plan requirement. This would require legislative action to delete the repeal of this authority, which takes effect on July 1, 2009.

The development of a comprehensive master plan by each local school system was one of the major accountability components of the Bridge to Excellence Act. The Act required significant enhancements to State funding for public elementary and secondary education and gave local school systems broad discretion to use the added revenues for programs, initiatives, and enhancements that would best serve local student populations. The master plans were designed to ensure that the large infusion of funds would be used on a focused set of identified strategies.

Local school systems were initially required to develop five-year plans and were required to update the plans annually during implementation of the Bridge to Excellence Act. Chapter 652 then added two additional years of mandatory plan updates (fall 2008 and 2009). In addition, the legislation required school systems to develop new five-year master plans by fall 2010 and required annual updates to those plans that would likewise cover five years. To allow the legislature to review the final report from the Bridge to Excellence evaluators before

proceeding with the mandates for 2010 and beyond, Chapter 652 includes a provision that requires the General Assembly to revisit these decisions in 2009.

Study Brings Changes to Master Plan Processes

The 2007 interim report of the Bridge to Excellence evaluation, which is being conducted by MGT of America under contract with the Maryland State Department of Education (MSDE), concluded that the master planning process has been beneficial to local school systems but could be improved. MGT is in the process of finalizing the Bridge to Excellence evaluation, which will be submitted to the Governor and the General Assembly by December 31, 2008.

MGT specifically identifies strategic planning as the most crucial factor in improving student performance and reports that local school systems that had used strategic planning processes prior to Bridge to Excellence demonstrated better student performance than those that had not. Furthermore, based on interviews with master planning teams and school district leaders, MGT's interim report concludes that, in a majority of local school systems, the master planning process has enhanced the involvement of and collaboration by key stakeholders, increased strategic planning and use of data for instructional decision making, and helped align expenditures with articulated goals and strategies.

Participants in the MGT study also identified numerous ways in which the master planning process could be improved. A common observation among respondents was that the process was overly burdensome and redundant and detracted from school system efforts to improve classroom instruction and student achievement. Recommendations for reducing the bureaucratic burden included standardizing formats for submission of data, eliminating redundant data requests, and allowing for electronic submissions of master plans and updates. Participants also noted that the timeline for submission of master plan updates was not aligned with budget processes or the reporting of results from State assessments, meaning the updates were not providing timely performance or financial data. Finally, more than half of assistant superintendents and almost one-third of superintendents suggested that master plan reporting requirements should be differentiated by various factors, including district size, performance, and Bridge to Excellence per-pupil funding levels. One master plan team suggested that updates be provided on a biannual basis.

In response to these concerns, MSDE instituted mandatory electronic filing of master plan updates using standardized templates. Data fields that contained information already in MSDE databases were prepopulated to save school systems time. Each system is still required to provide 10 hard copies of its master plan, including 1 signed by the superintendent and the board of education president. Also, the elimination of constructed responses on the high school assessments has shortened the time necessary to score the exams, so results are typically available in time for inclusion in the updates submitted by October 15 each year.

Mandate for New 2011 Master Plans Could Be Modified

Current law allows local school systems to use prior comprehensive plans to meet the Bridge to Excellence master plan requirement. This requirement was put in place at the outset to accommodate a handful of school districts that were already engaged in State-mandated strategic planning. Without further adjustment by the General Assembly, this portion of the law is due to expire before the 2010 master plans are submitted, meaning school systems would be required to develop entirely new master plans at that point. However, a majority of respondents in the MGT study report that master plan priorities have not changed significantly since the plans were first developed. If this is still true, some school systems could be allowed to continue providing annual or biannual updates to their existing plans instead of developing new plans. Additional strategic planning requirements could then be reserved for some of the systems that might benefit most from the process.

Education

Success of Early Education Programs Could Eventually Lead to Further Expansion

Since the 2007-2008 school year, all school systems in Maryland have been required to make prekindergarten programs available to all economically disadvantaged four-year-old children. Results from school readiness assessments conducted annually with kindergarten students suggest that readiness has improved as school systems have been phasing in the new requirement. A December 2007 report from the Task Force on Universal Preschool Education recommends continued expansion of voluntary publicly funded early education programs to all four-year-olds in the State by 2014.

Benefits of Early Childhood Education

Studies have consistently shown that quality early childhood education can have positive effects on children that last well beyond their elementary school years. Children who attend a high quality preschool program prior to entering kindergarten are less likely to repeat a grade, require less special education, demonstrate greater academic achievement, are more likely to graduate from high school, have a higher rate of attendance at four-year colleges, and are less likely to participate in criminal activity. These outcomes can have significant social and economic benefits, since they result in overall savings for school systems due to decreased demand for remediation and special education services, less demand on the criminal justice system, and increases in tax revenue as a result of the positive correlation between level of education and income. While the exact benefit-cost ratio of early childhood education varies from study to study, research has consistently shown that early childhood education programs provide benefits that surpass their costs, with some studies citing a benefit-cost ratio as high as 13 to 1.

Early Childhood Education in Maryland

In 1980, public schools in Baltimore and Prince George's counties participated in a State-funded pilot program to offer public prekindergarten programs for economically disadvantaged four-year-olds at risk of performing poorly in school. The program was made available statewide in 1982 through funding under the Extended Elementary Education Program.

The Bridge to Excellence in Public Schools Act of 2002 expanded the scope of early education by requiring local school systems to make publicly funded prekindergarten available to all economically disadvantaged four-year-old children by the 2007-2008 academic year. Prior to 2007-2008, public school systems provided prekindergarten to a similar population, but enrollment was dependent on the availability of space. State regulations also require local school systems to provide free prekindergarten services to homeless four-year-old children and

authorize school systems to enroll students who do not meet the eligibility criteria but are from populations that may exhibit a lack of school readiness. During the 2007-2008 school year, local school systems enrolled over 27,000 children in publicly funded prekindergarten programs, which is approximately 35 percent of four-year-olds in the State.

Due to potential space constraints in public schools, local school systems were authorized to contract with local Head Start programs and private prekindergarten providers to meet the Bridge to Excellence prekindergarten mandate. However, according to the December 2007 report of the Task Force on Universal Preschool Education, only three school systems entered into such arrangements during the 2007-2008 school year.

Task Force on Universal Preschool Education

Chapter 498 of 2006 established the Task Force on Universal Preschool Education, which submitted its final report, *Preschool for All in Maryland*, in December 2007. According to the report, 38 of the 50 states have state-funded prekindergarten programs, the majority of which are similar to Maryland's in that they serve four-year-old children from disadvantaged backgrounds. The task force recommended the development of a Preschool for All program in the State by 2014. Preschool for All would be a voluntary program in which all four-year-olds, regardless of family income, would have access to free prekindergarten services in public or private settings. Programs offered through private providers would have to meet the State's prekindergarten standards. Under Preschool for All, three-year-olds would be permitted to enroll in a prekindergarten program if the program has available slots after all four-year-olds seeking enrollment have been accommodated. The task force also recommended increased professional development for early childhood education staff and specification of standards of operation and accountability for prekindergarten that are similar to those in place for public prekindergarten programs, including teacher certification requirements, program accreditation, compliance with the Maryland Model for School Readiness/Voluntary School Curriculum, and implementation of school readiness assessments.

According to Maryland's Preschool for All Business Plan, submitted by the Maryland State Department of Education in September 2008, full expansion of publicly funded prekindergarten services to all four-year-olds expected to matriculate to public kindergarten would cost \$120 million. This estimate includes costs associated with enhancing programs to meet the improved quality standards recommended by the task force and parity in State-certified teacher pay as a result of the task force recommendation that prekindergarten teachers in public and private settings be certified. A feasibility study conducted at the request of the task force indicated that establishing a prekindergarten program for all four-year-olds in Maryland would eventually result in a benefit to the State of \$8.30 for every dollar spent.

School Readiness Assessment

Since 2001, kindergarten teachers in public schools have reported to the Maryland State Department of Education on the skills incoming kindergartners possess on 30 indicators of learning. These data are obtained through the school readiness assessment, which is conducted during the first grading period of the academic year and determines what behaviors students bring with them when they enter kindergarten. Children are classified as fully ready, approaching readiness, or developing readiness. The information reported on the assessment covers seven domains of learning (Language & Literacy, Mathematical Thinking, Scientific Thinking, Social Studies, The Arts, Physical Development, and Social & Personal). Among other benefits, the assessments can be used to gauge the impact of prekindergarten programs on school readiness.

According to the 2007-2008 data, 68 percent of kindergartners were fully ready for school, an increase of 19 percentage points from 2001-2002 levels and a 1 point increase since 2006-2007. Four percent of Maryland children needed considerable support to do kindergarten work, a 3 point decrease from 2001 levels. Twenty-eight percent of 2007-2008 kindergarten students were approaching readiness, a decrease of 16 percentage points from 2001. Kindergarten students also showed improvement across all seven domains of learning included in the assessment.

English language learners experienced a 20 point increase in their school readiness from 2001 to 2007; however, just 55 percent of English language learners were fully ready for school compared to 70 percent of English-proficient students. While children receiving special education services have made significant gains in school readiness since 2001, they did not improve at the same rate as their peers. Consequently, the gap in school readiness between special education students and their peers has grown by 10 percentage points since 2001.

Children enrolled in nonpublic nursery schools, child care centers, and prekindergarten programs demonstrated the highest levels of school readiness, while children who were at home or in informal care arrangements during the year prior to kindergarten exhibited the lowest levels of school readiness. School readiness data also indicate that improvements in school readiness skills over the past four years have contributed to a 14 point decrease in the gap between the performance of economically disadvantaged and nondisadvantaged third graders on the Grade 3 Maryland School Assessment.

Education

Efforts to Ensure Seamless Transfer of Adult and Correctional Education Underway

Chapter 134 of 2008 transfers adult education and literacy services and correctional services education from the Maryland State Department of Education to the Department of Labor, Licensing, and Regulation as of July 1, 2009. To facilitate the transfer, the legislation established a Workforce Creation and Adult Education Transition Council. The final report and recommendations from the council are scheduled for release by the end of December 2008.

Consolidating Workforce Development Skills and Training

In order to align adult education services with other workforce development skills training in the State, Chapter 134 of 2008 (Senate Bill 203) transfers adult education and literacy services and correctional services education from the Maryland State Department of Education (MSDE) to the Department of Labor, Licensing, and Regulation (DLLR) as of July 1, 2009. The specific programs that will transfer include the awarding of competitive grants for the provision of adult education and literacy services; the Adult External Diploma Program (EDP); the GED program; and education programs in correctional institutions. Continuation of the EDP will be governed by new regulations adopted by DLLR in consultation with the State Board of Education (State board); however, the State board will remain the entity that actually awards diplomas under the program. In contrast, continuation of the GED program and the awarding of GEDs will be governed by new regulations adopted jointly by DLLR and the State board. The Education and Workforce Training Coordinating Council for Correctional Institutions, chaired by the Secretary of Labor, Licensing, and Regulation and the Secretary of Public Safety and Correctional Services, is established to develop and recommend an educational and workforce training program for correctional institutions.

Workforce Creation and Adult Education Transition Council

In consideration of the complexities relating to the program, funding, and employee transfers, Chapter 134 established a Workforce Creation and Adult Education Transition Council to facilitate the transfers and recommend a framework for a new State system of adult education and workforce development programs. The council is jointly chaired by the State Superintendent of Schools and the Secretary of Labor, Licensing, and Regulation. The majority of the work of the council is being conducted by four workgroups: Adult Education; Correctional Education; Funding; and Internal Administration. Draft recommendations from each of the workgroups were presented at the November 12 meeting of the council and, with one noteworthy exception, almost all of the recommendations were approved by the council. Final recommendations and a report are expected at the end of December.

Recommendations of the Transition Council Workgroups

The recommendations of the workgroups were received by the council with only limited discussion or concern. Most of the discussion focused on the potential cost of the recommendations. Many of the recommendations require policy or operational changes and some require legislative or regulatory action. Any necessary legislative changes could be made in the 2009 session before the transfer takes effect July 1, 2009.

The recommendations related to adult education include increasing access to adult education programs by expanding the populations served to include individuals with diplomas but lacking basic skills (whereas the current State Plan for Adult Education prioritizes individuals without diplomas over other adult learners); aligning the State Plan with the Governor's Workforce Investment Board Mission and Vision and ensuring that adult education providers are represented on local Workforce Investment Boards; and merging and improving current data tracking of adult learners (assigning unique student identifiers). An increase in State funding for adult education from \$6.8 million was also recommended to match the amount (approximately \$9.0 million annually) allocated to Maryland from Title II of the federal Workforce Investment Act.

With regard to correctional education, the recommendations include providing incentives to incarcerated individuals for completion of educational and occupational programs; establishing permanent correctional education staff in order to reduce reliance on contractual employees; and expanding employer engagement strategies to enhance the pool of job opportunities that may be filled by skilled individuals who have been incarcerated.

Advisability of Transferring Correctional Education Services

Chapter 134 specifically charged the council with determining "the advisability of transferring correctional education services in light of the potential negative impact the transfer could have on the effective operation of juvenile services education." When juvenile services education was transferred from the Department of Juvenile Services to MSDE in 2004, to be phased in by 2012, MSDE researched best practices in other states and has utilized its existing infrastructure of adult correctional education programs and the expertise and experience of its adult correctional education staff to develop an effective delivery model and program for juvenile services education. Currently, MSDE reports that 10 positions have overlapping responsibilities relating to adult and juvenile correctional education programs including the director, various coordinators, and administrative staff.

The recommendation of the Internal Administration Workgroup in this regard was split. MSDE members of the workgroup assert that a transfer of adult correctional education services is inadvisable because of the cost that would be incurred to replace staff with overlapping responsibilities (estimated at \$476,000), the coordination that is needed between the juvenile and adult programs, and the funding and professional development that the two efforts currently share. The DLLR members suggest that the council should seek specific information relating to

the extent of the overlapping responsibilities of staff and other coordinated and shared resources. The council tasked the Internal Administration Workgroup with obtaining further detail to be presented at the council meeting in early December.

The Carl D. Perkins Career and Technical Education Act

In order to support the continuous improvement of career and technology education programs (CTE), the federal government allocates approximately \$18 million annually to Maryland under the reauthorization of the federal Carl D. Perkins Career and Technical Education Act of 2006. The Act defines an “eligible agency” as “a State board designated or created consistent with State law as the sole State agency responsible for the administration” of CTE in the State. The Act allows up to 1 percent of the funds allocated to be used to serve individuals in State institutions (but does not specify the types of institutions). In Maryland, consistent with the State Plan for Career and Technology Education, the 1 percent allocation is allocated for the benefit of individuals in State correctional institutions.

Although CTE did not transfer to DLLR from MSDE under Chapter 134, language in the law authorizes DLLR to join MSDE in cooperating with federal agencies in administering, securing the benefit of, facilitating the transfer of funds under, and representing the State relating to the Act. This joint administration, security, facilitation, and representation may jeopardize the \$18 million that Maryland receives under the Act if the federal government interprets the collaboration as a violation of the requirement for a “sole State agency” to serve this purpose.

Education

Compulsory School Attendance Age Gets Continued Attention

In an effort to retain the roughly 10,000 students per year who drop out of high school, legislation has been introduced in each of the last seven years to increase the age of mandatory school attendance in Maryland; however this legislation has not passed. A Task Force to Study Raising the Compulsory Public School Attendance Age to 18 that was established through 2006 legislation submitted its final report in December 2007. The task force acknowledged the hardships faced by those who drop out of high school but did not specifically recommend that the age of compulsory school attendance be increased.

2008 Legislation

Every year since 2002, the General Assembly has considered bills that would have raised the minimum age at which students may drop out of school from 16 to either 17 or 18. An average of more than 10,000 students per year dropped out of Maryland public high schools from the 1998-1999 school year to the 2006-2007 school year, and proponents of the legislation argue that increasing the compulsory age of attendance would help to decrease the number of dropouts and would eventually increase the number of high school graduates in Maryland.

Due at least in part to the high cost of adding a large number of students to the annual enrollment counts, legislation increasing the mandatory attendance age has had little success. However, during the 2008 session, the Senate passed Senate Bill 436, which would have raised the age of compulsory attendance by one year for the 2009-2010 school year contingent on the inclusion of \$45 million in the fiscal 2011 State budget to help pay for the added enrollment. The bill ultimately failed in the House of Delegates, but the Senate's approval of the bill suggests that this issue will persist.

Task Force Examines an Increase in the Compulsory School Attendance Age

The Task Force to Study Raising the Compulsory Public School Attendance Age to 18, established by Chapter 449 of 2006, submitted its final report in December 2007. The task force reported that students who drop out of high school face "harsh futures" characterized by lower wages, disproportionate representation in prisons, and shorter overall life spans, according to national studies. The costs to society were also noted, including greater dependency on public assistance among dropouts and high incarceration costs for that population.

The task force also found several factors that would make increasing the age of compulsory attendance difficult, including the significant operating and capital costs associated with the change and the ongoing shortage of qualified teacher candidates. The study estimated

that annual operating costs, including both State and local costs, would increase by \$200 million and that one-time capital costs for portable classrooms would be approximately \$46 million. This financial burden would be unequally distributed among local jurisdictions since each school system has a different dropout rate and differing amounts of available classroom space. As estimated by the task force, Baltimore City, the jurisdiction with the largest number of dropouts, would face the greatest financial burden (\$60 million), while Talbot County would have the least financial burden (\$385,000).

The task force did not specifically recommend that the age of compulsory school attendance be raised but did encourage strong use of student supports to assist students who are at-risk of dropping out. Furthermore, the task force recommended that, if the State does increase the age of mandatory school attendance, it should provide adequate financial support for the endeavor. Other recommendations of the task force included:

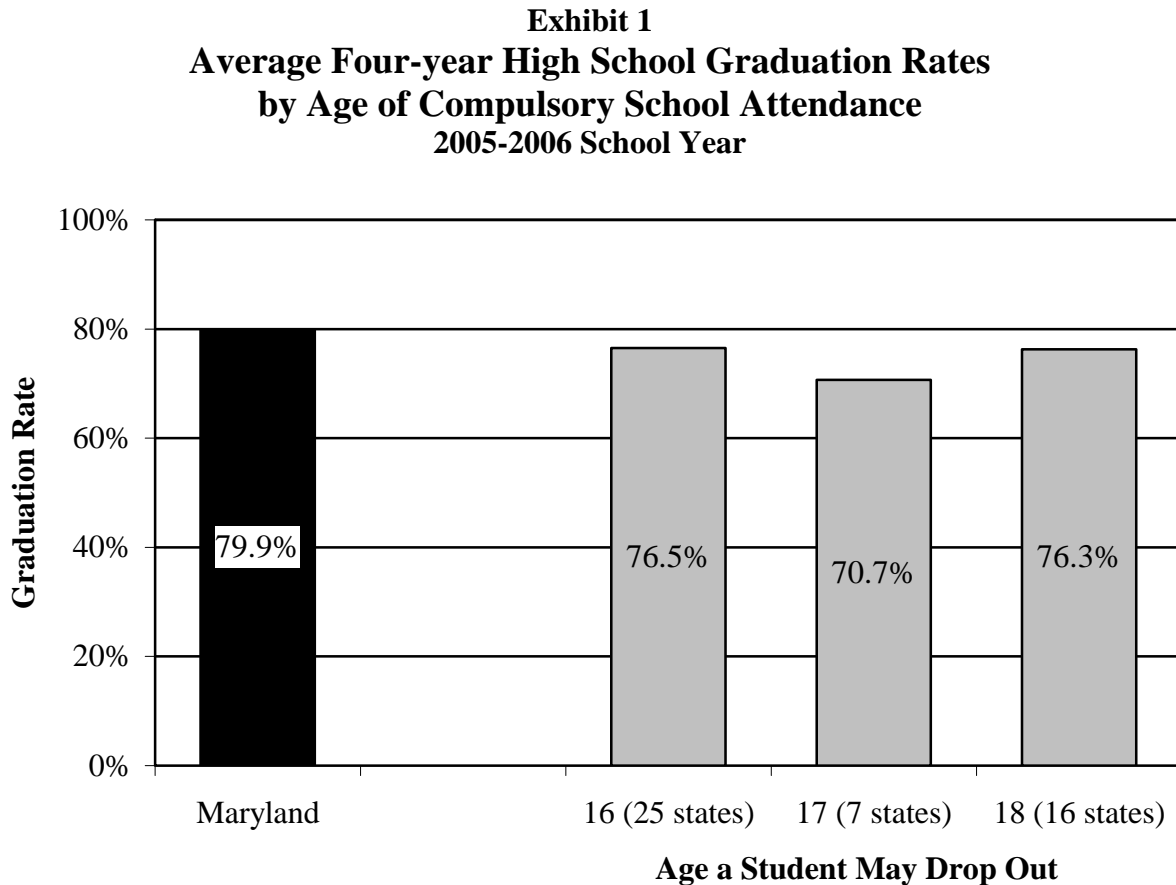
- adoption of a statewide dropout prevention initiative addressing different modes of instruction and appropriate strategies for current dropouts and those at risk of dropping out;
- development of alternative pathways to the Maryland high school diploma, including work study beginning in grade 9, a five-year high school program, instruction at times outside the traditional school schedule, and recognition of the GED as a valid credential; and
- assessment of the effectiveness of truancy courts for dropout prevention.

Compulsory School Attendance Policies in Other States

Currently, the minimum age at which students may drop out is 16 in 23 states, 17 in 9 states, and 18 in 18 states and the District of Columbia. Since 1996, 8 states have raised the age of compulsory attendance to either 17 or 18 years-of-age. Most statutes provide for various exceptions allowing a student to leave school earlier than the required age. For example, the majority of states have exceptions for students who have completed the high school graduation requirements and have received a high school diploma or its equivalent. Other states grant exceptions for students with temporary illnesses or injuries; students with physical, mental, or emotional disabilities; students who get parental consent to drop out; and students who live a certain distance from a school, bus stop, or public highway.

The final report of the Task Force to Study Raising the Compulsory Public School Attendance Age to 18 suggests that some states have raised the compulsory attendance age with some retention success when community services for students at-risk of dropping out have been provided in combination with the age change. However, **Exhibit 1** shows no real difference in average statewide graduation rates between states that allow students to drop out at 16 and those that do not allow students to drop out until they reach 17 or 18. Although further review of the

policies and demographics in other states would be necessary before any firm conclusions could be drawn, these data suggest that simply raising the compulsory school attendance age may not yield immediate increases in high school graduation rates.



Note: 2005-2006 graduation rates were not available for two states (PA and SC) and the District of Columbia. Compulsory attendance ages from the 2005-2006 school year are used in the chart in order to align with the most recent available graduation rates. Unweighted averages of graduation rates in states within each compulsory attendance age group are shown.

Source: National Center for Education Statistics and the final report of the Task Force to Study Raising the Compulsory Public School Attendance Age to 18.

Higher Education

Commission to Develop the Maryland Model for Funding Higher Education to Submit Final Report in December 2008

The Commission to Develop the Maryland Model for Funding Higher Education will submit a final report in December following two years of study. The commission is finalizing recommendations that provide a funding model for higher education based on a group of 10 states with which Maryland competes for employers and jobs. The commission is also considering recommendations from a panel of experts hired to examine the funding needs of Maryland's historically black institutions (HBIs), which concluded that the HBIs are not yet comparable and competitive with traditionally white institutions.

Commission to Conclude Two Years of Study with Final Report

The Commission to Develop the Maryland Model for Funding Higher Education was established by the Tuition Affordability Act of 2006 (Chapters 57 and 58). The Lieutenant Governor, legislators, cabinet secretaries, representatives of the higher education community, members of the business community, and members of the public comprise the commission. The commission is charged with reviewing options and making recommendations relating to the development of a statewide framework for higher education funding that will be consistent and stable, will ensure that all of Maryland's public higher education institutions are affordable and accessible to the State's residents, and will promote policies to achieve national eminence at all of Maryland's public institutions of higher education. The commission must also make funding recommendations to ensure that Maryland's historically black institutions (HBIs) are comparable and competitive with other public institutions in the State.

Chapters 57 and 58 directed the commission to issue a final report of its findings and recommendations on or before December 31, 2007; however, the commission was unable to complete its charge by that date, so legislation was enacted (Chapter 45 of 2008) authorizing the commission to submit an interim report in December 2007 and extending the deadline for the final report to December 2008. The commission held its first meeting in January 2007, met on a regular basis during the 2007 interim, and began meeting again during the 2008 interim. The commission met frequently throughout the fall and will submit a final report by December 31, 2008. The report will include findings and recommendations that address its charges, and legislation will be introduced in the 2009 session to implement the commission's recommendations.

Draft Recommendations Focus on a Funding Model

To facilitate the commission's work, four workgroups were formed in September 2007: Appropriate Funding Shares; Accountability; Economic Competitiveness and Workforce; and Capital Investment. The workgroups' preliminary recommendations were included in the commission's 2007 interim report. The workgroups continued to meet throughout 2008, including several meetings during session. The commission received the workgroups' reports in early November. The findings and recommendations of the workgroups will be used to inform the recommendations of the commission in the final report.

A work session on the draft recommendations was held in mid-November followed by a public hearing to provide an opportunity for the public and other interested parties to testify before the commission. The commission has scheduled at least one meeting in December to review the draft final report.

The commission's draft recommendations include a proposed funding model for higher education based on a group of 10 states that Maryland competes with for employers and jobs. These "competitor states" comprise the peer group to which Maryland is compared in the model to develop appropriate funding goals for public four-year institutions, resident undergraduate tuition levels, and need-based financial aid. The funding model also endorses the formulas currently used to fund community colleges and eligible private nonprofit institutions. Other recommendations under consideration include reauthorizing the Higher Education Investment Fund, which is scheduled to sunset after fiscal 2009; developing a report card for higher education to measure progress in meeting the goals of the funding model and the State Plan for Postsecondary Education; and encouraging institutions to set aside funds for capital facilities renewal.

HBI Study Panel Makes Recommendations

In order to properly address the commission's charge relating to funding for HBIs, the commission hired a panel with HBI and higher education finance expertise to develop recommendations. The panel made a preliminary report in September and presented its final report to the commission in October.

The HBI Study Panel focused on undergraduate and graduate education at the HBIs. With regard to undergraduate education, the panel noted that it should be the first priority of all state universities and that earning a bachelor's degree should be the key measure of success. Therefore, one of the panel's main recommendations is that the "capacity of HBIs in undergraduate education should provide the opportunity to raise graduation rates to levels approaching those" of Maryland's traditionally white institutions (TWIs). The panel further recommended that graduation rate should be the primary criterion used to determine competitiveness in HBI outcomes. The panel strongly emphasized the ambitiousness of this goal. To determine the appropriate funding needed to achieve this goal, the panel recommended

that the Maryland Higher Education Commission (MHEC) coordinate a group of HBIs and experts to outline the programs and services needed to ensure that students who are less prepared for college eventually graduate. The panel noted that the Access and Success Program, a State-funded program to improve graduation rates at the HBIs since 2001, does not have common or specific criteria and appropriate goals and accountability.

In its recommendations on graduate education, the panel focused on the doctoral programs at Morgan State University and the University of Maryland Eastern Shore. The panel recommended that each university develop a detailed strategic plan designed to improve its institutional platform to make it comparable to a quality doctoral institution. The panel recommended submission of the strategic plan to MHEC, which would subsequently provide recommendations to the Governor and the legislature to establish a comprehensive program and provide the resources to make each university comparable to a quality doctoral institution. Additionally, the panel recommended that the institutions and the State should begin by agreeing to target a few existing doctoral programs and should appoint a panel of experts for each selected program to determine the threshold support and capacity needed for each of the targeted programs.

Finally, the panel found that the facilities at the HBIs lag behind the facilities at the TWIs. The panel recommended that the HBIs review their capital priorities through fiscal 2013 based on the physical capacity that will be needed to become comparable and competitive and, if warranted, priorities should be reordered to align with the goals of comparability and competitiveness.

The commission will consider the recommendations of the panel in its deliberations on funding recommendations that will ensure that Maryland's HBIs are comparable and competitive with other public institutions in the State.

Higher Education

State and Federal Governments Attempt to Address High Cost of College Textbooks

As the cost of college textbooks has increased faster than inflation, calls to curb the increases have led to discussion at the State and national levels. Although 2008 legislation to comprehensively address the issue failed to pass both houses in Maryland, a federal law that takes effect in July 2010 includes many similar provisions. In some cases the proposed Maryland bill went further than the federal law, suggesting that further steps could be taken to develop a comprehensive effort to address rising textbook costs. A summit on textbook affordability sponsored by Maryland higher education institutions is a positive first step.

The Rising Cost of Textbooks in Higher Education

In 2005, the Government Accountability Office (GAO) reported that during the period between 1986 and 2004, tuition and fees at institutions of higher education increased 240 percent and textbook prices increased 186 percent. By comparison, during this same period, inflation increased only 72 percent. Among other factors, the increase in textbook costs can be attributed to the imperfect market in which textbooks are sold; the greater availability of supplemental instructional materials, including technologically advanced products; the bundling of textbooks with supplemental instructional materials as a single sale; and various barriers to competition.

Although legislation to address high textbook costs at the State level has been proposed in each of the last several years, none has passed. The recent passage of a federal law that includes some of the textbook cost-control proposals considered by the General Assembly this past session demonstrates the attention that this issue has generated. However, curbing the rising cost of textbooks would be best addressed through a comprehensive effort jointly supported by students, faculty, bookstores (both on-campus and off-campus), publishers, and the administrators of higher education institutions.

Selection of Textbooks and Supplemental Instructional Materials

The selection of textbooks and supplemental instructional materials is complex. First and foremost, there is consensus that academic freedom must not be compromised in any attempt to lower the cost of textbooks and supplemental instructional materials. Second, there seems to be consensus that the integrity of the textbook adoption process should be preserved, if feasible. In a typical textbook adoption process, the faculty member first selects a textbook, then notifies a textbook coordinator or bookstore of the textbook's International Standard Book Number (ISBN), a unique book-specific number. In some instances, the bookstore immediately orders the textbook. In other instances, the bookstore may inform the faculty member of a bundled option (*i.e.*, a joint packaging of the textbook with supplemental instructional materials), an

insufficient availability of the requested textbook, or the impending publication of a new edition. The faculty member may then select a bundled option or a new or different textbook, in which case the adoption process starts anew.

One of the advantages of a faculty member's selection of bundled materials is that the actual cost of the bundle, although higher than the textbook alone, is lower than the total monetary value of all of the items in the bundle. This advantage is sometimes diminished, however, because faculty members do not always use the supplemental instructional materials, and some students do not need the extra instruction provided by the materials. Furthermore, return policies for bundles are often inflexible.

An Imperfect Market

The textbook market is an imperfect market that is supply driven rather than demand driven. Textbooks are "supplied" to students by bookstores and other vendors (such as online vendors) having been "demanded" by the college faculty teaching the course. The student-consumer has no role in determining price, format, or quality of the product; however, the student is the purchaser of the product.

Online vendors and used book bookstores are not fully utilized for the sale of textbooks in higher education. In part, this is due to the fact that students and off-campus bookstores often do not receive textbook selection information in a timely manner (if at all). When students and off-campus bookstores *do* receive textbook selection information, often this information does not include the ISBN, edition, or supplemental instructional material information. Further, custom textbooks, specific to a course or institution, often eliminate buy-back value and are difficult for off-campus bookstores to stock.

Legislative Initiatives Intended to Curb the Rising Cost of Textbooks

Federal Law

In August 2008, the U.S. Congress included provisions related to textbook pricing as part of the federal Higher Education Opportunity Act (Pub. L. No. 110-315, § 112). Effective July 1, 2010, this law requires publishers to provide faculty members with the price at which a textbook will be made available to a bookstore, the copyright dates of the three previous editions of a textbook (if any), and a description of any substantial content revisions such as new chapters, new themes, or new subject matter made between a current and prior edition. Publishers that offer bundles must offer textbooks and supplemental instructional materials as separate and unbundled items. To the maximum extent practicable, institutions of higher education must provide the ISBN and retail price information regarding textbooks for each course listed in the course schedule on an institution's web site.

Legislative Initiatives in Maryland

Following a legislatively mandated study of this issue during the 2007 interim, Senate Bill 657/House Bill 1067 of 2008 comprehensively addressed the issue of rising textbook costs. Similar to the federal law, the Senate version of the bill would have required publishers to disclose the price at which a textbook would be made available, variances in pricing between bundled and unbundled products, and substantial content revisions. However, Senate Bill 657 would have gone further than the federal law by requiring publishers (and campus bookstores) to provide and sell textbooks in the same manner as selected and ordered by faculty and to make bundled materials available both as the requested bundle and as separate items for sale to students. Senate Bill 657 also would have required a higher education institution to provide to any bookstore (including an online vendor), upon request and concurrently with the provision of textbook information to the campus bookstore, various identifying information for each textbook, including the ISBN and the anticipated enrollment for the course, and then to post the same information on its web site for students and the rest of the public within one week. The Senate version of the bill additionally required institutions of higher education to permit equal advertising and student access to bookstores other than campus bookstores, upon request.

The House version of the bill was substantially similar to the Senate version; however, the House amendments allowed for a three week period, rather than one week, after identification of the textbook for students and the rest of the public to be made aware of textbook-related information and struck the provision that would have required equal advertising and student access. The two versions of the legislation were not reconciled in time for final passage.

Next Steps

Despite the failure of textbook-related legislation during the 2008 session, institutions of higher education in Maryland are aware of the high cost of textbooks and are actively trying to ameliorate the problem. Almost all of the higher education institutions in the State offer used book sales and most offer some sort of textbook buy-back program. Institutions encourage faculty to adopt textbooks early and to take into consideration the possibility of e-books, pricing, and the reuse of older editions of textbooks. St. Mary's College has recently implemented an online textbook swap program, and the College of Southern Maryland is exploring a textbook rental program. In addition, almost all institutions in the State discourage bundling.

Although the federal law makes strides in the national effort to combat the rising cost of textbooks in higher education, the federal law does not preclude further effort from state legislatures or from academic institutions, publishers, bookstores, faculty, and students. A summit hosted on November 24, 2008, by the University System of Maryland, Morgan State University, St. Mary's College, the Maryland Association of Community Colleges, and the Maryland Independent College and University Association is a positive first step.

Higher Education

Third Year of Tuition Freeze Increases Affordability of Higher Education

In response to double-digit tuition increases in the first half of the decade, the State has subsidized a tuition freeze for in-state undergraduates at fall 2005 rates for the past three years at most public institutions of higher education. As a result, Maryland's tuition rankings have improved but remain high relative to public institutions in other states. State appropriations for public institutions have increased significantly over the past four years raising the question of how long the State can afford to freeze tuition. State financial aid has also increased in response to tuition increases, with the largest increases attributable to need-based aid.

Rising Tuition Leads to Freeze

Two factors that influence students' and families' decisions on whether college is affordable and accessible are tuition at the preferred institution and the availability of financial aid to help pay for tuition and other associated costs of higher education. State support for institutions of higher education and financial aid plays a key role in making college more affordable and accessible.

Over a three-year period from fall 2001 to 2004, in-state tuition and fees at Maryland's public four-year institutions increased by an average of 33 percent, or 10 percent per year. During the same period, State support for the institutions decreased 12 percent, with the declines in State funding coinciding with the sharpest increases in tuition and fees. State funding rebounded in fiscal 2006, increasing 6.7 percent as growth in tuition and fees also moderated to 6.7 percent for fall 2005, less than the increases from recent past years but still higher than the 4 percent average annual increases in tuition prior to 2001.

State Funding Increases to Support the Tuition Freeze

In response to the rising tuition rates, the Tuition Affordability Act of 2006 (Chapters 57 and 58) was enacted, freezing tuition during the 2006-2007 academic year at the fall 2005 rates for in-state undergraduate students attending University System of Maryland (USM) institutions and Morgan State University (MSU). The Act also limited the fall 2006 tuition increase at St. Mary's College of Maryland (SMCM) to 4.8 percent. General funds were used to offset the loss of tuition revenues at USM, MSU, and SMCM. The Tuition Affordability Act of 2007 (Chapter 294) continued the freeze of in-state undergraduate tuition rates at USM and MSU for the 2007-2008 academic year. The fiscal 2008 budget included \$16.2 million in general funds to offset the loss of tuition revenue. In fiscal 2009, \$16.3 million was included in the budget from the Higher Education Investment Fund (HEIF) to continue the tuition freeze for a third consecutive year.

Since tuition has been frozen at fall 2005 rates, State appropriations for the public four-year institutions have increased significantly, by 15.5 percent in fiscal 2007 and 7.2 percent in fiscal 2008. In fiscal 2009, the General Assembly approved a 9.9 percent increase in State appropriations for USM, MSU, and SMC. Cost containment approved by the Board of Public Works in October has reduced the appropriation by \$16.3 million, not including a transfer of \$20 million from the USM fund balance that will require legislative approval in the 2009 session. Although this year's tuition freeze was not mandated in statute, USM and MSU have not proposed mid-year tuition increases to replace the lost State funds. However, the State's projected structural budget deficit of over \$1 billion for fiscal 2010 raises the question of how long the State can continue the tuition freeze.

Tuition Freeze Improves Affordability of Maryland Institutions

The three-year tuition freeze has made four-year public institutions more affordable for Maryland students and families. **Exhibit 1** compares actual fall 2008 tuition rates with estimated rates assuming annual 4 percent increases since fall 2005. While tuition has been frozen for three years, student fees have not been; since fall 2005, fees have increased 6.1 percent. Overall, tuition and fees increased 1.4 percent on average at Maryland's public institutions for 2007-2008, well below the national average of 6.2 percent reported by the Washington Higher Education Coordinating Board.

Despite the freeze, Maryland remains a relatively high tuition State. In 2005-2006, Maryland's flagship institution (University of Maryland, College Park) was ranked the tenth most expensive in the country, while tuition at the State's eight comprehensive institutions ranked fifth nationally. In 2007-2008, the ranking for Maryland's flagship dropped to nineteenth but comprehensive institutions remained in the top 10 nationally, dropping to the seventh most expensive in tuition costs.

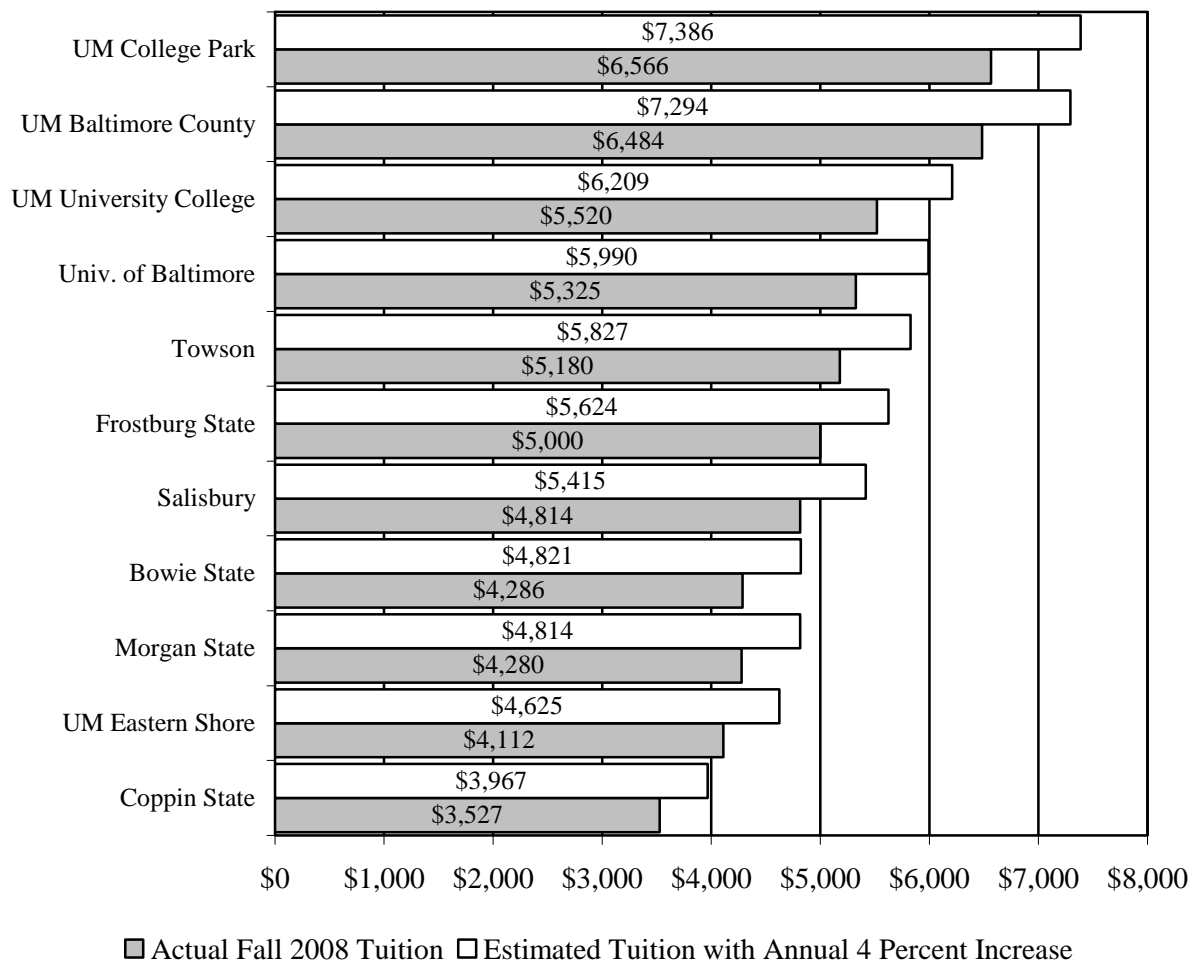
Increases in Tuition and State Financial Aid Differ

The amount of financial aid awarded to students impacts the affordability of Maryland's higher education institutions. Aid options include federal programs, aid provided by the State, and financial assistance offered by institutions. Need-based aid is given to students who demonstrate financial need. Other State financial aid, which can usually be received in addition to need-based aid, is given to students who are pursuing degrees in fields with workforce shortages, students who have special talents and skills, and students who have earned good grades.

Over the past seven years, increases in State appropriations for financial aid have generally kept pace with increases in tuition and fees at Maryland's public four-year institutions. Since fiscal 2003, State appropriations for financial aid have increased from \$79 million to \$109 million or 36.8 percent. Over the same period, from fiscal 2003 to 2009, average tuition and fee rates for resident undergraduates at public four-year institutions in Maryland increased 35.4 percent. Most of the growth in financial aid has been in need-based aid, increasing from \$43 million to

\$85 million or 94.4 percent. This is partly due to the shift of funds from the HOPE Scholarship program, which was phased out during the period, to need-based programs.

Exhibit 1
Estimated Impact of Resident Tuition Freeze at USM and MSU
Fall 2008

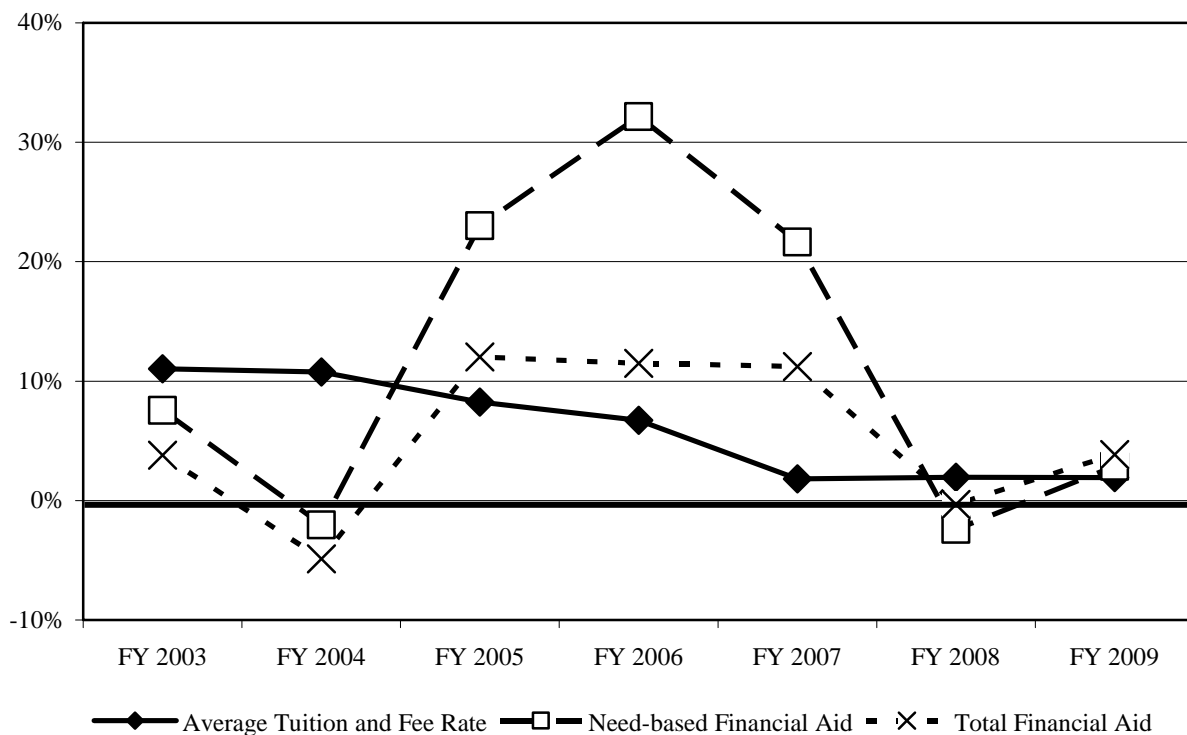


Source: University System of Maryland, Department of Legislative Services

State financial aid increases did not keep pace with tuition and fee increases each year, particularly in the years leading up to the tuition freeze. **Exhibit 2** shows the increase in average tuition and fees compared to the percent change in State financial aid. Tuition increases were greater than the increases in State appropriations for both need-based aid and all financial aid in fiscal 2003 and 2004. However, need-based aid increased significantly in the years following the largest tuition increases. Since fiscal 2007, as general funds were allocated to institutions to offset the tuition freeze, need-based aid and total aid have essentially been level funded. State appropriations for financial aid decreased by \$5.9 million in fiscal 2008 due to cost containment, although an estimated

\$5.0 million from prior year scholarship appropriations was carried forward and available in the Maryland Higher Education Commission budget to be expended in fiscal 2009. Fiscal 2009 cost containment actions have so far reduced need-based aid by \$1.3 million.

Exhibit 2
Annual Percentage Increase in Resident Undergraduate Tuition and Fee Rates at Four-year Public Institutions Compared to Annual Percentage Change in State Financial Aid Appropriations
Fiscal 2003-2009



Higher Education

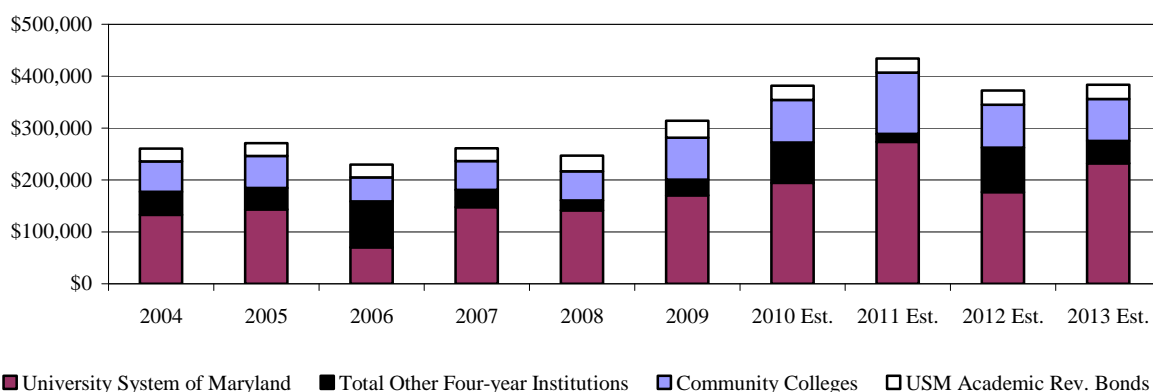
Capital Support for Public Higher Education Increases

The fiscal 2010 capital budget request for public two- and four-year institutions totals almost \$500 million, more than \$100 million above the planned funding level for fiscal 2010. The Maryland Higher Education Commission's Finance Policy Committee has recommended \$423.3 million in funding. In addition, a report on capital management from Morgan State University is expected before the 2009 session begins.

Higher Education Capital Request Totals Nearly \$500 Million in Fiscal 2010

After hovering at around \$250 million for the past five years, the public higher education capital budget increased to over \$300 million in fiscal 2009. As shown in **Exhibit 1**, the Governor's 2008 *Capital Improvement Program* (CIP) projects an increase again in fiscal 2010 to \$381.5 million and remains at this higher level through fiscal 2013.

Exhibit 1
Public Higher Education Capital Funding
Fiscal 2004-2013
(\$ in Thousands)



Source: Department of Legislative Services, Governor's 2008 *Capital Improvement Program*

The public four-year universities and two-year colleges submitted a total request of \$497.8 million to the Maryland Higher Education Commission (MHEC) for fiscal 2010. The request for the four-year institutions totaled \$352.2 million in general obligation (GO) bonds, including \$257.2 million in GO bonds and \$27.0 million in academic revenue bonds for projects at seven University System of Maryland (USM) institutions and the USM Office. St. Mary's College of

Maryland (SMCM) requested one project totaling \$1.7 million. After reviewing USM and SMCM's requests, the MHEC Finance Policy Committee recommended approval to the full commission.

Morgan State University (MSU) requested \$78.4 million in GO bonds for nine projects. MHEC's Finance Policy Committee approved five of the projects for a total of \$67.3 million. It did not recommend two projects because they do not appear in the Governor's CIP and deferred another project for two years. The committee also recommended deferring \$2.7 million for second phase design of the New Business School. The first phase design funding was withheld in fiscal 2009 pending the hiring of a capital project management consultant by MSU and the submission of reports to the General Assembly and the Board of Public Works. As of November 2008, the required reports had not been submitted. This issue is discussed further in the final section of this paper.

Unlike four-year institutions, capital support for community colleges is funded as a lump-sum grant rather than individual project authorizations. The 2007 *Joint Chairmen's Report* requested that the individual colleges submit a joint request with projects listed in priority order. Used for the first time in the 2008 session, the new process takes into account many factors, although the overriding variable is individual priorities. Each college's top priority is ranked above any other's second priority. The Governor's CIP has programmed \$80.0 million for fiscal 2010, while the entire community college capital request totals \$145.6 million for 22 projects at 12 campuses. MHEC's Finance Policy Committee recommended that the full commission approve a grant of \$82.0 million, funding the top five projects. A year ago, only one college, Prince George's Community College (PGCC), had an unfunded project. It was guaranteed that this project would be at the top of the fiscal 2010 request, and it is. Likewise, the seven top-priority projects that would go unfunded in fiscal 2010 will presumably be at the top of the fiscal 2011 request.

Overall, MHEC's Finance Policy Committee recommends \$423.3 million in GO bonds for public higher education capital funding. MHEC meets on November 18, 2008, to make final recommendations, which will be forwarded to the Governor and the General Assembly.

Update on Space Deficiencies and Quality of Space

Exhibit 2 shows overall space needs at Maryland's public four- and two-year institutions in fall 2007, the most recent data available. The only surplus is in the two-year institutions' classroom space, with 42,938 net assignable square feet more than was needed in 2007. All other space types have deficiencies at both segments, and larger deficits are projected in 10 years. Research space has by far the largest need, and the need is almost exclusively at University of Maryland, College Park and the University of Maryland, Baltimore.

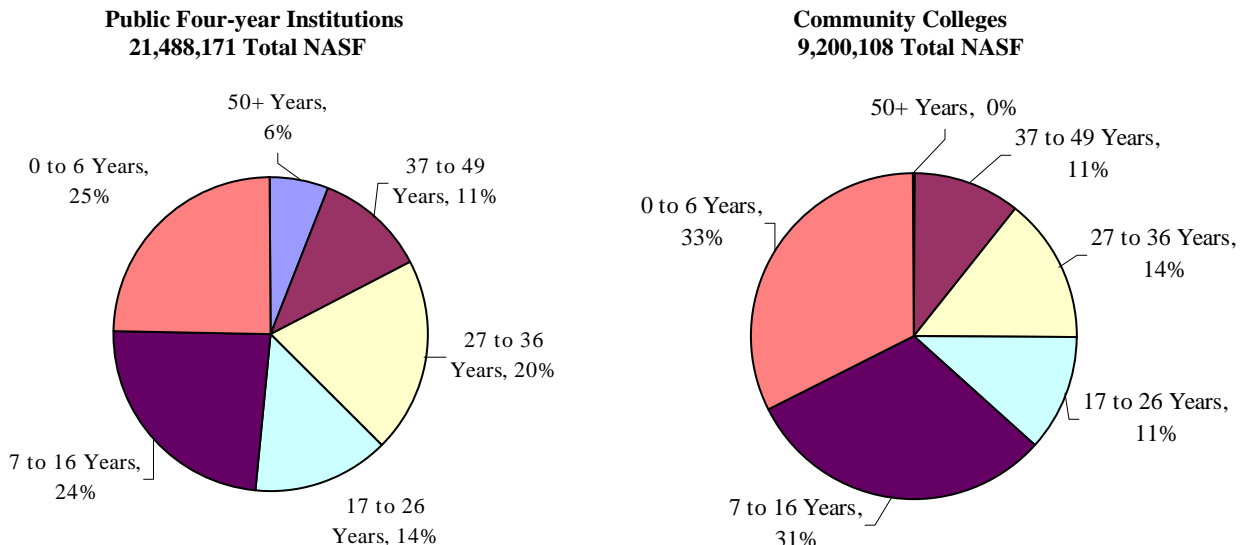
Exhibit 2
Space Deficiencies at Maryland's Public Colleges and Universities
Fall 2007

	<u>Classroom</u>	<u>Laboratory</u>	<u>Office</u>	<u>Research</u>	<u>Total</u>
4-year Public Institutions	(193,836)	(363,062)	(367,681)	(1,932,198)	(2,856,777)
2-year Public Institutions	42,938	(426,776)	(277,027)	N/A	(660,865)
Total	(150,898)	(789,838)	(644,708)	(1,932,198)	(3,517,642)

Source: Maryland Higher Education Commission

Although space deficiencies are an important piece of data, the quality of existing space is also important. One way to measure it is by age. The State currently builds buildings to last at least 50 years, with systems such as heating and electrical wiring expected to last between 25 and 35 years before a renovation is necessary. **Exhibit 3** shows the age of space at public four-year institutions and community colleges since either construction or the most recent major renovation of the space. While the majority of space in both segments is under 27 years old, there are significant space inventories over that age.

Exhibit 3
Age of Space in Higher Education
Fall 2007



NASF: Net Assignable Square Feet

Source: Maryland Higher Education Commission

New Procurement Procedures for Morgan State University

On February 8, 2008, the Department of Legislative Services Office of Legislative Audits (OLA) released significant findings pertaining to the management and oversight of capital projects at MSU. The findings included splitting change orders for projects to fall below the monetary threshold that requires Board of Public Works (BPW) approval, questionable payments made to contractors, and authorizing work even though funding was not available. The findings of the audit prompted the General Assembly to restrict \$3.9 million in capital funding for fiscal 2009 until MSU satisfied several criteria. First, MSU must retain a management consultant to review MSU's capital project management and to make recommendations to ensure appropriate oversight of capital projects by the university and the Board of Regents. The consultant's report will be submitted to MSU, OLA, the budget committees, and BPW. Additionally, MSU must revise its internal procedures to address the consultant's recommendations. Finally, MSU must report its new procedures to the budget committees, OLA, and BPW, and they must be approved by BPW.

Through a competitive procurement process, MSU has hired a consulting firm to study MSU's capital project management. A preliminary report was due November 3, 2008, and a final report is due December 3, 2008. Additionally, MSU has established an internal Capital Construction Review Committee (CCRC) that is comprised of staff leaders from several departments, including physical plant, capital planning, and procurement, as well as the internal auditor. CCRC reviews all active projects to ensure compliance with State and university requirements and provides oversight of all BPW items. Through this review, CCRC has identified three similar issues in addition to those found in the audit. These findings have been reported to the Board of Regents and BPW for consideration and action.

Higher Education

Regional Higher Education Centers Face Funding and Policy Issues

Maryland has eight regional higher education centers (RHECs) that play an important role in meeting workforce development needs and can be particularly important as Maryland prepares to address the impact of the 2005 Base Realignment and Closure plans that could bring more than 45,000 jobs to the State. RHECs receive State funding to operate, but a group charged with examining the RHECs has found that State support is uneven across the centers and has recommended fully funding a strategy based on equitable funding. RHECs also face other policy issues that should be addressed, including their role in meeting educational needs and their diverse governance structures.

RHECs Provide Access to Higher Education in Underserved Areas

Regional higher education centers (RHECs) are designed to ensure access to higher education in unserved and underserved areas of the State by extending the existing program resources of higher education to those areas. RHECs provide baccalaureate and graduate programs in areas of the State in which students do not have access to these programs due to geographical distance, commute time, or the limited capacity of local four-year institutions. RHECs offer the State an opportunity to address workforce needs in high-demand areas, particularly for nontraditional students, and to support State, regional, and local economic and workforce development goals.

Through the RHECs, all regions of the State can be provided with a well-educated workforce critical to the success of the Base Realignment and Closure (BRAC) transition, the economic development of the regions, and the State as a whole. The final BRAC plans that became effective in November 2005 will result in an estimated total of more than 45,000 federal and private-sector jobs in Maryland, and many of the jobs will require specialized or technical training. Maryland faces the challenge of adequately preparing its workforce for the types of jobs made available by BRAC and the challenge of successfully delivering training and higher education opportunities to underserved geographic areas affected by the BRAC relocations. To assist with these challenges, Maryland can look to its RHECs.

RHECs Receive Uneven Funding and Face Policy Issues

A regional higher education center is a facility operated by an institution of higher education in the State that has the participation of two or more institutions, offers multiple degree levels, and consists of a variety of program offerings.

There are a total of eight RHECs in Maryland. Two are governed by the University System of Maryland (USM): the Universities at Shady Grove and USM at Hagerstown. Six centers fall under the coordinating responsibility of the Maryland Higher Education Commission (MHEC), and each center has its own governance and organizational structure. These centers are:

- Anne Arundel Community College (AACC) Regional Higher Education Center at Arundel Mills
- Eastern Shore Higher Education Center
- Higher Education and Conference Center at the Higher Education and Applied Technology Center (HEAT)
- Laurel College Center
- Southern Maryland Higher Education Center
- Waldorf Center for Higher Education

The *2008 Joint Chairmen's Report* required the Commission to Develop the Maryland Model for Funding Higher Education (Maryland Model Commission) to review the funding for the eight RHECs and to make recommendations regarding the RHECs in its final report in December 2008. The commission charged one of its workgroups with the task of examining the RHECs.

Funding

The two USM centers are funded as line items in the USM Office operating budget. The other six centers are funded by grants through the MHEC operating budget. State capital funding for the USM centers is a part of USM's capital process. The other six centers' capital requests are handled on a case-by-case basis.

In 2005, the General Assembly charged MHEC with developing an equitable, consistent, and ongoing funding strategy for the non-USM RHECs. The funding strategy developed by MHEC contains the following components:

- *Base allocation* for each center (\$200,000);
- *Incentive funding* for target full-time equivalent students (FTES) (2+2 lower division, upper division, and graduate) tied to the inflation adjusted fiscal 2005 general fund appropriations per FTES at the Universities at Shady Grove;
- *Lease funding* for centers with leased space that have not received State capital funding support; and
- *Special funding* for one-time projects or startup costs.

The funding strategy was implemented beginning with fiscal 2008 budget requests but has not been fully funded to date. RHECs, including the two USM centers, received a total appropriation of \$10.2 million in fiscal 2008. **Exhibit 1** shows the State operating funding per estimated FTES for each center in fiscal 2008. The average State funding per FTES in fiscal 2008 at the USM centers was \$4,993, compared to \$778 at the non-USM centers. However, if the funding strategy had been fully implemented in fiscal 2008, the average State operating funding per FTES at the non-USM centers would have been \$5,093. The fiscal 2009 budget included an increase of \$800,000 for the non-USM centers to begin to address the funding inequity, although the amount has been reduced by \$133,000 as a result of cost containment.

After examining these data, the workgroup concluded that State support has been lower and less consistent for the centers outside of USM. Although an equitable funding strategy has been developed for the six non-USM centers, it has not been funded to date. To provide for a more equitable and consistent funding stream, the workgroup recommended that the funding strategy for the six non-USM centers should be implemented and funded. For fiscal 2010, it would cost a total of \$3.95 million to provide full support for the funding strategy.

Exhibit 1
State Operating Funds for RHECs
Fiscal 2008

	<u>Funds per Estimated FTES</u>
Universities at Shady Grove	\$4,456
USM at Hagerstown	8,788
AACC RHEC at Arundel Mills	1,220
Eastern Shore	2,090
Higher Education Center at HEAT	458
Laurel College Center	909
Southern Maryland	740
Waldorf Center	622

Source: Maryland Higher Education Commission

Governance and Roles of RHECs

The six non-USM RHECs have different governance structures ranging from independent boards, community college advisory boards, and intersegmental governance. Unlike the USM centers, affiliated entities are not governed by the same body; therefore, getting institutions to

participate in the centers is sometimes difficult. The Maryland Model Commission workgroup recommended the establishment of another group to examine and recommend one standard governance structure for each center, or best practices that each center should adopt, to provide level ownership for all partners or incentives to offer programs at the centers.

The workgroup also concluded that even though centers are defined to have a specified purpose, the overall role of these centers is not clearly defined; therefore, each center operates differently and provides different types of courses. The workgroup recommended that before additional RHECs are approved to operate in the State, an analysis should be performed to determine the educational needs of the surrounding area. The analysis should include what role the RHEC will play in meeting these needs, whether some or all of the needs are being met through existing means, and, if not, whether an RHEC is the best way to meet them.

The Maryland Model Commission is likely to include several of the workgroup recommendations for RHECs in its final report in December 2008.

Health and Health Insurance

Efforts to Stabilize the Prince George's County Health Care System

The effort to restore fiscal stability to the Prince George's County Health Care System is proceeding apace. With a funding commitment from the State and Prince George's County in hand, a legislatively created hospital authority is actively seeking new ownership for the system.

Background

The Prince George's County Health Care System consists of several operating divisions: the Prince George's Hospital Center, a 264-bed acute-care hospital and regional referral center; the Gladys Spellman Specialty Hospital and Nursing Center, a 107-bed comprehensive care and chronic care facility; Laurel Regional Hospital, a 123-bed acute-care community hospital and special hospital rehabilitation center; and the Bowie Health Center, which includes a freestanding, rate-regulated emergency care facility and the Larkin Chase Nursing and Rehabilitation Center, a 119-bed nursing home in which the system owns a 25-percent minority investment. These facilities are leased to Dimensions Healthcare System by Prince George's County under a long-term Master Lease Agreement.

Over the past decade, Dimensions has experienced severe financial difficulties. As a consequence, both the State and Prince George's County have had to provide short-term financial support to the system. However, despite government support, the system's finances remain inadequate.

2007 Special Session

During the 2007 special session, legislation was adopted to attempt to secure the long-term future of the system. Chapter 2 of the 2007 special session included language authorizing the Governor to transfer \$20 million from the Dedicated Purpose Account to the Department of Health and Mental Hygiene to provide a grant to an independent entity with authority over the system until the facilities in the system could be transferred to a new owner. However, the grant could not be made until a long-term comprehensive solution to the system's problems was reached either through legislation or a memorandum of understanding (MOU) between the State and Prince George's County. Similar language was added to Chapter 7 of the 2007 special session providing the same contingency to proposed grants for the system.

2008 Legislation

Building on the framework that was established during the 2007 special session, Chapter 680 of 2008 created the Prince George's County Hospital Authority, a seven-member public body, tasked to achieve a long-term, comprehensive solution for the system. The legislation directs the Authority to establish and implement an open, transparent, and competitive bidding process for the purpose of transferring the Prince George's County Health Care System to one or more new owners.

Chapter 680 includes several key deadlines to facilitate the successful transfer of the system to a new owner. Specifically, the bill requires:

- the Governor and Prince George's County to reach agreement within 60 or 90 days after the Authority is established on the funding that the State and Prince George's County will commit for support of the system if the bidding process results in an agreement to transfer the system to a new owner;
- the Authority, within 90 or 120 days after the Authority is established, to develop and issue a request for proposals (RFP) for the sale or transfer of the system and to determine a timeframe and deadlines for the submission of bids and selection of a successful bidder; and
- a successful bidder to be selected and an agreement to transfer the system to a new owner before the beginning of the 2009 session, with the possibility of a 60-day extension.

In addition, Chapter 680 provides for short-term, interim financial support for Dimensions of \$12 million from both the State and Prince George's County for each of fiscal 2009 and 2010, if a long-term funding agreement is reached within 60 or 90 days after the Authority is established.

Work of the Prince George's County Hospital Authority

On May 22, 2008, the Governor signed the Prince George's County Hospital Authority legislation, and on June 13, 2008, he announced the State appointees to the Authority. In July 2008, the State and Prince George's County executed an MOU to document the commitment of \$174 million in public funding to help stabilize and facilitate the transfer of the system to a new owner, triggering the State and Prince George's County's obligation to pay \$12 million each in fiscal 2009 and 2010 for operating support during the search for a new owner. As shown in **Exhibit 1**, the State and Prince George's County agreed to each provide \$75 million over five years beginning in fiscal 2011, with the State committing an additional \$24 million in capital support over three years beginning in fiscal 2012.

Exhibit 1
Prince George's County Health Care System
State and County Commitments
Fiscal 2009-2015
(\$ in Millions)

<u>Fiscal</u> <u>Year</u>	State Support		<u>County</u> <u>Support</u>
	<u>Operating</u>	<u>Capital</u>	
2009	\$12		\$12
2010	12		12
2011	15		15
2012	15	\$8	15
2013	15	8	15
2014	15	8	15
2015	15		15
Total	\$99	\$24	\$99

Source: Memorandum of Understanding between Prince George's County and the State of Maryland

In August 2008, the Authority retained the services of two firms to assist in the valuation, marketing, and issuance of RFPs for the system. The bidding process has been divided into two phases:

- The first phase, begun in September 2008, consists of several steps, including sending out a marketing document to notify interested persons that the Authority is initiating a process to transfer control and ownership of the system. The Authority reported that this document was sent to 84 entities across the country. This phase also includes providing potentially qualified buyers with a detailed assessment of the system and requiring potential bidders with an interest in proceeding to the next phase of the bidding process to complete a questionnaire addressing issues involved in the operation and management of health care systems. According to the Authority, interest has been positive.
- Phase two of the bidding process will begin in November 2008. This phase will consist of the final steps of the process, including the submission of a nonbinding letter of intent or indication of interest by an entity interested in bidding on the system. Potential bidders who have completed the questionnaire will receive a document outlining the evaluation process and general criteria to be applied to bids by the Authority in its evaluation and selection of a new owner. Finally, the Authority will select a bidder or

bidders with whom to negotiate quasi-binding offers to be presented to stakeholders at the beginning of the 2009 session.

Conclusion

The establishment of the Prince George's County Hospital Authority and the execution of an MOU between the State and Prince George's County committing long-term financial support to the system represent significant steps to solving the problems of the Prince George's County Health Care System. Although the work of the Authority is not yet complete, its work appears to be on-track to achieve the goal of transferring the system to a new owner. If the RFP process is successful, the General Assembly, as well as other stakeholders, will be presented with a potential bidder or bidders at the beginning of the 2009 session.

Health and Health Insurance

Rosewood Closure Update

A recent report from the Department of Health and Mental Hygiene (DHMH) revises the original DHMH plan guiding the closure of Rosewood Center. Ongoing concerns are the available capacity for forensic individuals, some lingering family opposition to community placement, and the ultimate disposition of the property.

Background

In January 2008, the Governor announced the closure of Rosewood Center, amid repeated findings by the Office of Health Care Quality (OHCQ) concerning safety issues related to the buildings and grounds of the facility as well as behavioral issues between clients and staff. These findings threatened to violate the conditions for Medicaid funding. The facility is planned to fully close by June 2009.

When the closure was announced, there were 166 individuals residing at Rosewood – 136 were non-court-involved, and 30 were placed in the custody of the Developmental Disabilities Administration (DDA) by the court. Rosewood Center had been the almost exclusive referral site for individuals who were incompetent to stand trial and ordered by the court into DDA's care. As a result of OHCQ's findings, all admissions to Rosewood were frozen and redirected to Potomac Center and Holly Center.

The plan to close Rosewood Center includes transitioning all non-court-committed individuals to community placements; placing court-committed individuals in community care settings or in an alternative long-term care forensic unit; and transitioning employees from Rosewood, to the extent possible, to the newly created forensic units or other positions within the Department of Health and Mental Hygiene (DHMH).

In September 2008, DHMH submitted a report outlining the final plan for the transition of individuals out of Rosewood Center as required by the 2008 *Joint Chairmen's Report*. The report contained the final plan for the long-term care of court-committed individuals, a status report on all individuals in transition, and a plan for any individual or guardian who wishes to remain in a State residential center (SRC).

Non-court-committed Individuals

In the original transition plan submitted by DHMH in January 2008, all 136 non-court-committed individuals living at Rosewood at the time of the closure announcement were determined to be best served in community settings. To appropriately plan for transition into the community, DDA employs an Essential Life Planning (ELP) process which

assists in discerning the individuals' needs, outlines a service plan, and helps to identify an appropriate community service provider. The current placement status of these individuals as of September 1, 2008, is as follows¹:

- 28 individuals have completed the ELP process and have moved into community settings that meet both their service and habilitation needs;
- 51 individuals have completed the ELP process but have yet to be placed in the community;
- 37 individuals have ELP meetings currently scheduled; and
- 20 individuals have not yet scheduled an ELP meeting.

DDA will consider admission to an existing SRC if an individual and his/her family has participated in the planning process but have not found a viable community option that will meet the individual's service and habilitation needs. If a suitable community placement is not found, an application to an SRC must be submitted, and the individual must meet the requirements for admission to an SRC as outlined in Health General Article § 7-502.

Court-committed Individuals

In coordination with stakeholder input, emergency regulations were submitted and approved by the Joint Committee on Administrative, Executive, and Legislative Review (AELR) in June 2008 for two new forensic units: a therapeutic evaluation unit at Jessup and a therapeutic long-term unit at Sykesville.

The Jessup therapeutic evaluation component will be a secure unit on the grounds of Clifton T. Perkins Hospital. The unit was operational in July 2008 and is intended to house a maximum of 12 individuals for 21 to 90 days. During this time, DDA completes competency and behavioral evaluations and develops a comprehensive service plan for the individual. After the evaluation period, an individual will either be placed at the long-term unit at Sykesville or in an appropriate community placement. DDA is also seeking to expand community placement opportunities to safely manage individuals with court involvement and has developed an Invitation for Proposals from community providers to expand these services. DDA anticipates that expanded services will be available in the community by December 2008.

The therapeutic long-term care facility will be a secure unit on the grounds of Springfield Hospital at Sykesville. DDA is in the process of making security enhancements to the Sykesville building and training staff. DDA estimates that it will be operational by December 1, 2008, and will house a maximum of 20 individuals who have been identified through the Jessup evaluation unit.

¹ Placement status is based on the 2008 *Joint Chairmen's Report* as well as updated information from DHMH.

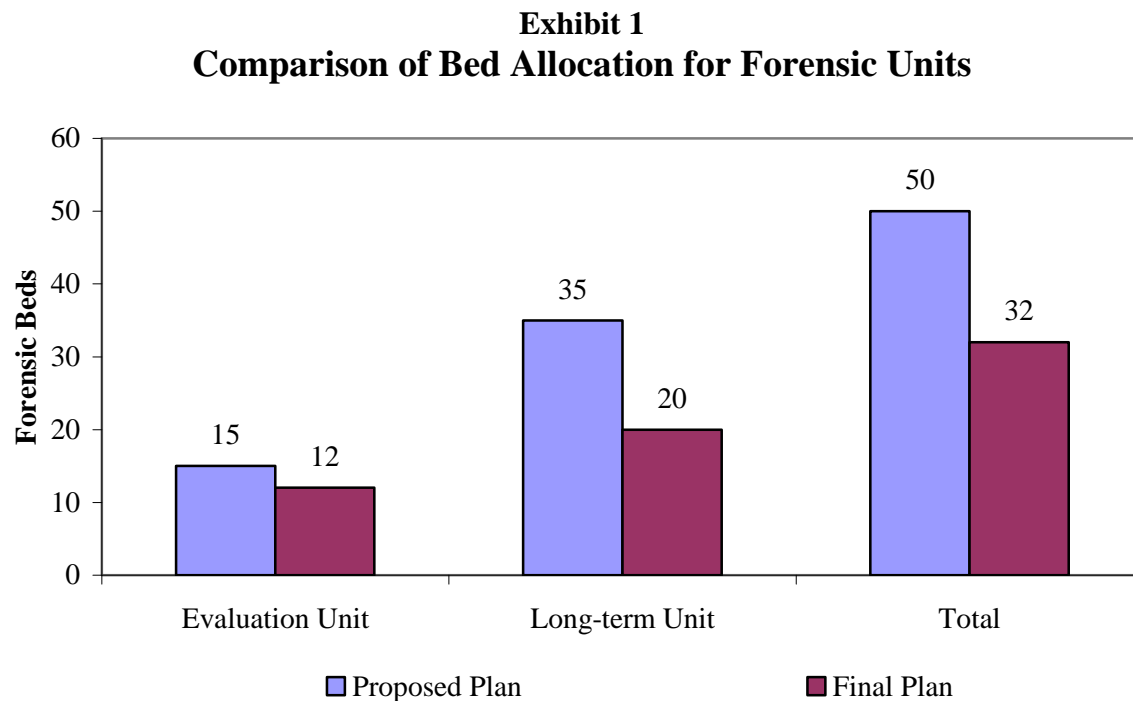
Employees of Rosewood

When the closure of Rosewood was announced, there were just over 500 full-time equivalent (FTE) positions at the facility. Board of Public Works action in October abolished 33.8 FTE vacant positions at Rosewood. DDA will transition approximately 110 positions to the new forensic units at Jessup and Sykesville. Additionally, DHMH is in the process of transferring positions from Rosewood to other units within DHMH. It is unclear at this time the exact number of positions that will be eliminated with the closure of Rosewood.

Ongoing Policy Concerns

Forensic Capacity

As shown in **Exhibit 1**, in the original budget plan submitted to the committees, DDA requested a total of 50 beds for the forensic units: 15 at the evaluation ward and 35 across two long-term care facilities. The revised September 2008 plan provides for only 32 beds for court-committed individuals: 12 at the evaluation unit at Jessup and 20 at the long-term care unit at Sykesville. DDA concedes that capacity may ultimately be an issue at Sykesville, with 9 of the Rosewood residents at the time of closure to be initially placed on that unit.



Source: Department of Health and Mental Hygiene

While DDA makes recommendations for service and habilitation needs for each court-committed individual, the court system makes the final decision as to the service plan. Although the courts usually concur with DDA's findings and recommendations, there are instances when the court overrules DDA's decision. In these instances, DDA may not have full control over whether an individual is ultimately placed in Sykesville or a community setting. The inability to expand the number of beds to meet the demand placed on DDA from the courts may pose a problem in the future.

Lingering Resistance to Community Placement

Despite the fact that the department is making progress completing the ELP process, there still remain a large number of individuals who will need an appropriate community placement by June 2009. Indeed, some family members and guardians continue to oppose community placement. DDA must work with those families to reach a suitable long-term care plan in a timely manner.

Property Disposition

Another policy consideration faced by the General Assembly will be the disposition of the Rosewood facility and the land after the facility is closed sometime next year. When the closure is complete, DHMH may declare the property to be "excess real property" as identified by State Finance and Procurement Article §5-310, thus beginning the process of disposing of the land under current State law. During the 2008 session, two bills were introduced in the House and the Senate that would have established a commission to determine how best to use the land or turned the land into a State park, respectively. Ultimately, both bills were similarly amended and established a Commission on Land Use at the Rosewood Center, staffed by the departments of Health and Mental Hygiene, General Services, and Planning. The bills failed but were of significant interest to residents living near Rosewood, Baltimore County, and advocates for the developmentally disabled.

Although the bills failed, language was included in the 2008 *Joint Chairmen's Report* requesting DHMH to submit a report addressing, amongst other things, the viability of retaining portions of the property to provide day programs, medical services, and inpatient and outpatient services for individuals receiving services in Central Maryland. Since the closure of Rosewood is inevitable and imminent, it is likely that the General Assembly will again be considering legislation during the 2009 session dealing with the disposition of the property.

Health and Health Insurance

Health Care Reform: Maryland, Other States, and the President-elect

<p>Access to health care continues to be a concern nationally. Maryland's recently enacted health care expansion has begun enrollment. Massachusetts has had success in significantly reducing its uninsured population, though other challenges remain, while other states have taken a more incremental approach to health care reform. President-elect Obama has made health care reform a priority.</p>
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Background

Access to health care continues to be a concern for Maryland and other states. The U.S. Census Bureau reported that in 2007, for the first time since 2000, the nation's uninsured population decreased. However, the decrease was primarily due to an increase in enrollment in government programs, with the number of people covered by employer-based insurance remaining level. This paper will discuss the progress of Maryland's recent health care expansion, provide an overview of health care expansion efforts in other states, and describe the main components of the President-elect's plan for health care.

Health Care Expansion in Maryland

Chapter 7 of the 2007 special session expanded eligibility for Medicaid by increasing eligibility for parents and caretaker relatives with dependent children up to 116 percent of the federal poverty guidelines (FPG) and by incrementally increasing eligibility for health care services through Medicaid for childless adults with incomes up to 116 percent FPG. For one adult, 116 percent FPG is \$12,064. For a family of three, 116 percent FPG is \$20,416. Chapter 7 also created a health insurance subsidy program for small employers with two to nine employees who did not offer health insurance to their employees in the year prior to applying for the subsidy.

Medicaid Expansion

The expansion of eligibility for parents with dependent children took effect on July 1, 2008. Prior to July 1, eligibility for parents with dependent children was approximately 46 percent FPG. The expansion is estimated to cover an additional 36,420 individuals in fiscal 2009: 16,605 previously uninsured parents and caretaker relatives; 10,609 children already eligible for but not enrolled in Medicaid; and 9,206 individuals already insured that would drop coverage and instead enroll in Medicaid.

As of October 15, 2008, 14,595 adults with dependent children have enrolled in Medicaid as a result of the expansion. The Department of Health and Mental Hygiene is still analyzing the extent to which enrollment of children has increased as a result of the expansion.

Prior to the health care expansion, the State offered primary health care services through a Medicaid program called the Primary Adult Care Program for adults up to 116 percent FPG. During fiscal 2009, the Medicaid expansion will continue to provide primary care services to adults who are not parents or caretaker relatives with incomes up to 116 percent FPG. The next phase of expansion of services to these childless adults in fiscal 2010 calls for the provision of specialty medical care and hospital emergency department services. Additional levels of service are provided in subsequent fiscal years. All of this service expansion is dependant on funding availability in the State budget, although the major impact on the State's general fund does not occur until fiscal 2011.

Small Business Subsidy

The Maryland Health Care Commission (MHCC) is charged with administering the health insurance subsidy for small businesses created by the health care expansion, which includes establishing wage and salary requirements for participation in the program, defining a wellness benefit, and establishing any other requirements needed. Currently, MHCC requires the average wage of full-time employees of a business to be below \$50,000 in order to be eligible for a subsidy. Also, an employee of an eligible employer must have a family income of less than \$75,000 to seek an additional subsidy for coverage of any dependents.

Enrollment in the small business subsidy began on September 9, 2008. Four health insurance carriers are providing a total of nine plans that are compatible with the subsidy. As of November 1, 2008, 48 businesses have enrolled in the subsidy program, with a total of 245 newly covered individuals under the program. MHCC reports that the low enrollment in the program is likely due to the economy and concern over whether the program will continue to be funded. The total annual subsidy for the individuals currently enrolled is \$285,457.

Health Care Expansion Financing

Financing for the State health care expansion is provided by \$75 million of the surplus in the Maryland Health Insurance Plan; approximately \$76 million of surplus in the Rate Stabilization Fund; and savings from averted uncompensated care taken from hospital rates. Regardless of whether additional services for childless adults continue to be implemented or not, there will be no general fund spending on the health care expansion until fiscal 2011. **Exhibit 1** compares estimated spending, between fiscal 2010 through 2013, with implementation of expansion of services for childless adults and without expansion.

Exhibit 1
Funding Estimates of Health Care Expansion Enacted by
Chapter 7 of the 2007 Special Session
Fiscal 2010-2013
(\$ in Millions)

<u>Funding Sources</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>	<u>2013</u>
With Expansion for Childless Adults				
General Funds	\$0.0	\$67.8	\$187.2	\$204.1
Special Funds	140.4	144.3	197.9	219.6
Federal Funds	120.4	181.0	352.1	388.6
Total Funding	\$260.9	\$393.1	\$737.3	\$812.4
Without Expansion for Childless Adults				
General Funds	\$0.0	\$15.5	\$80.4	\$86.1
Special Funds	105.9	110.8	58.6	65.0
Federal Funds	85.9	95.1	105.9	116.1
Total Funding	\$191.8	\$221.5	\$244.9	\$267.2

Note: Numbers may not sum to total due to rounding.

Source: Department of Legislative Services

Health Care Reform in Other States

In 2006, Massachusetts and Vermont implemented comprehensive health care reform, aimed at achieving universal coverage in each state. Other states and jurisdictions have taken more incremental approaches to increase access to health care.

Massachusetts and Vermont

On April 12, 2006, Massachusetts enacted legislation to provide near-universal health care coverage to Massachusetts residents through a variety of private and public insurance market reforms. Massachusetts now requires both employers and individuals to purchase health insurance and provides subsidized health insurance to individuals up to 300 percent FPG. Massachusetts has had great success in reducing its uninsured rate: the Urban Institute estimates that the uninsured rate went from 13 to 7 percent, while Massachusetts estimates that the uninsured rate in the state is now as low as 5 percent. The Urban Institute also has found that health reform in Massachusetts was responsible for approximately one-fifth of the nation's decline in the uninsured rate in 2007.

However, Massachusetts has experienced budget difficulties due to the health care expansion, mainly due to the larger than expected number of enrollees in free or subsidized programs and lower than expected revenues from employer assessments.

In 2006, Vermont also enacted comprehensive health care reform. Vermont requires employers to provide coverage but does not require individuals to purchase health insurance. Vermont opened its subsidized health plan, Catamount Health, in November 2007. In May 2006, Vermont had approximately 67,000 uninsured residents. As of September 2008, approximately 6,000 individuals had enrolled in Catamount Health.

Other States

Most states, like Maryland, have tried to increase access to care through more incremental approaches. For example:

- States, such as Connecticut and Florida, have created lower-cost health care policies that do not provide a full range of benefits.
 - Connecticut created the Charter Oak Health Plan for adults that have not had health insurance for six months. The plan is offered by several insurers in Connecticut, and the state provides premium subsidies for adults with lower incomes. The plan began taking applications on July 1, 2008, and as of September 24, 2008, had enrolled approximately 1,000 individuals.
 - In May 2008, Florida enacted a law that allows low-cost insurance policies to be sold to Florida residents who are age 19 to 64, uninsured, and not eligible for public insurance. Insurers issuing the low-cost policies may not reject applicants for the policies based on age or health status. However, the policies do not have to include mandated benefits and may limit the amount of visits for which they will reimburse or place a cap on the level of reimbursement for services. The plans are expected to be offered in Florida beginning in January 2009.
- Some states have focused on providing universal coverage to children.
 - Pennsylvania, for example, covers children through its Children's Health Insurance Program (CHIP) up to 300 percent FPG; parents with incomes above that level may buy into the program at the full cost, which is approximately \$160 per child per month on average.
 - New Jersey recently enacted a law that requires all children to have health insurance by July 2009. New Jersey's CHIP covers children up to 350 percent FPG and allows parents with greater incomes to buy into its program at a cost of \$137 per month for one child, \$274 per month for two children, and \$411 per month for three or more children.

Obama's Plan

On November 4, 2008, Senator Barack Obama was elected to become the next president of the United States. One of President-elect Obama's campaign platforms was health care reform. Obama's plan for health care includes the following components:

- requiring health insurance plans to cover preexisting conditions;
- creating a National Health Insurance Exchange where individuals can purchase either a public health insurance plan or approved private plans;
- providing tax credits for individuals to pay their health insurance premiums;
- providing tax credits for small businesses for up to 50 percent of premiums paid by the small business on behalf of their employees;
- requiring large employers that do not contribute at a certain level to the cost of their employees' health coverage to pay a percentage of payroll toward the cost of the national plan;
- requiring children to be covered, and allowing young people up to age 25 to stay on their parents' insurance plans;
- expanding Medicaid and CHIP; and
- reimbursing employer health plans for a portion of the catastrophic costs they incur above a threshold if they guarantee that the savings will be used to reduce employee premiums.

President-elect Obama's health plan also includes a number of initiatives aimed at promoting disease management, improving health care quality, and controlling health care costs. The plan also provides that states' health care coverage innovations will not be preempted, if the standards in their plans meet the standards of the federal public health insurance plan.

Requiring health insurance companies to cover preexisting conditions might eliminate the need for the State's high risk pool, the Maryland Health Insurance Plan. Expansion of Medicaid and CHIP could favorably impact on the State's budget. But without more specific details, it is difficult to pinpoint with certainty what impact President-elect Obama's health plan would have on states.

Conclusion

The problem of access to health care continues to be of great concern. Massachusetts has made great strides in covering its uninsured, but at a significant monetary cost. Unless significant health care reform moves forward at the national level, further comprehensive health care expansion in Maryland and other states will largely depend on the availability of funds.

Health and Health Insurance

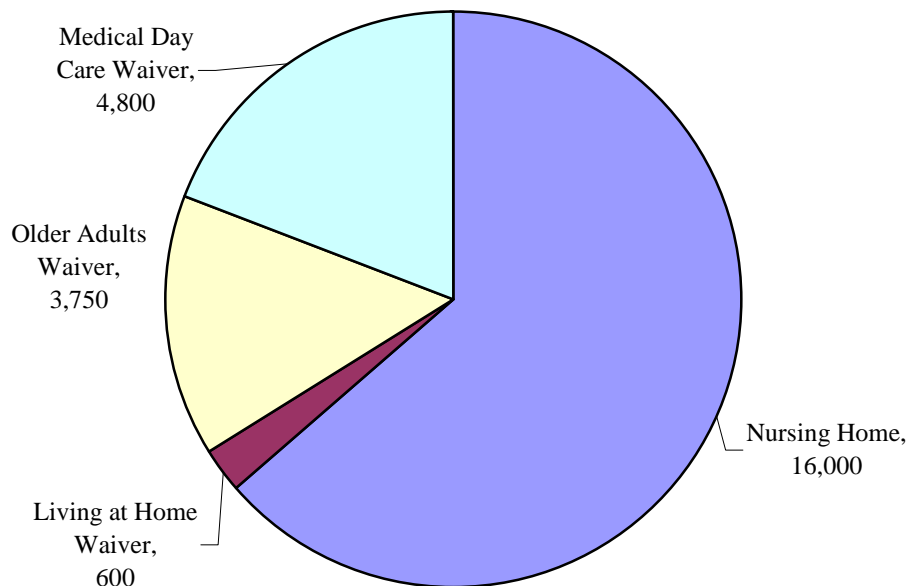
Medicaid Long-term Care Issues

To rein in the cost of long-term care services, the Department of Health and Mental Hygiene (DHMH) had proposed moving to a managed long-term care model, but that proposal was scrapped. At the same time, Maryland's highest appellate court recently upheld a lower court ruling invalidating the restrictiveness of the State's nursing home level of care assessment. Additionally, DHMH has made some modifications to the Medicaid long-term care program, but the department continues to state that more comprehensive long-term care reform is a priority.

Background

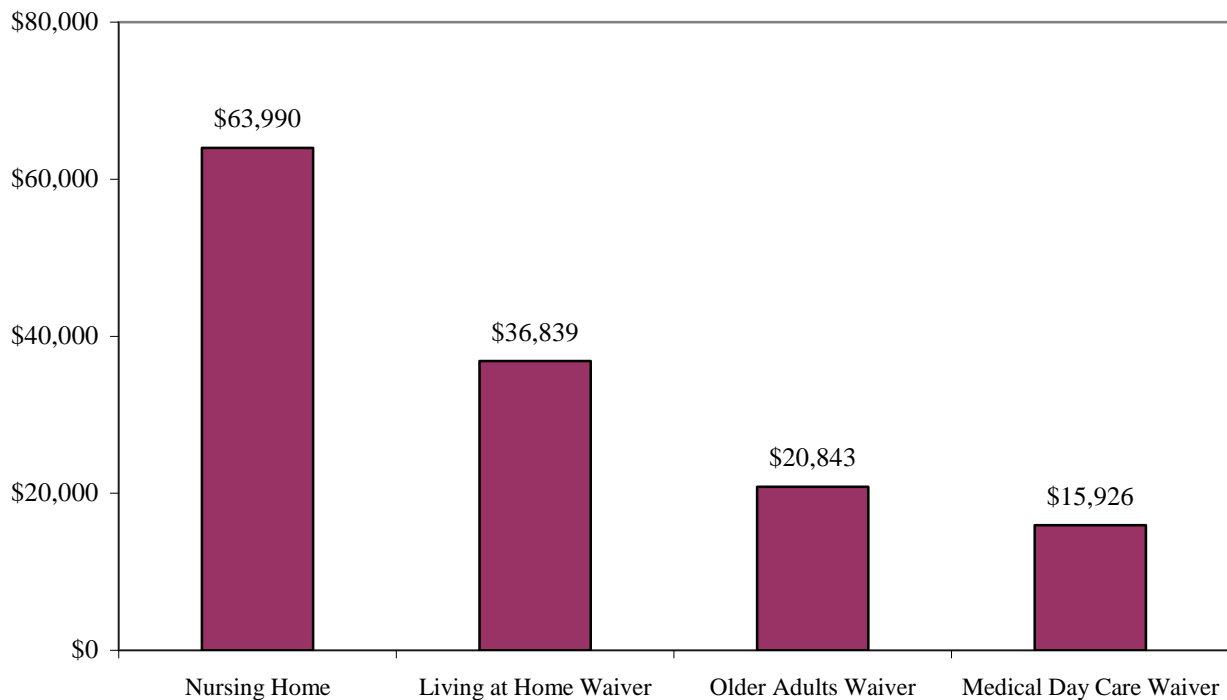
Medicaid funds almost half of the long-term care services provided in Maryland, and Medicaid funding for those services amounts to \$1.3 billion, which is almost 25 percent of all Medicaid expenditures. As shown in **Exhibit 1**, a majority of the long-term care services provided are nursing home services, but home- and community-based services are also available. However, as shown in **Exhibit 2**, home- and community-based services are less expensive and are the preferred option of Medicaid enrollees.

Exhibit 1
Medicaid Long-term Care Slots by Type of Care
Fiscal 2009



Source: Department of Health and Mental Hygiene; Department of Legislative Services.

Exhibit 2
Average Cost Per Slot
Fiscal 2009



Source: Department of Health and Mental Hygiene; Department of Legislative Services.

In recent years, the Department of Health and Mental Hygiene (DHMH) has unsuccessfully attempted to reform the Medicaid long-term care system. At the same time, the department is currently a party to a lawsuit regarding the eligibility standard used by the State to qualify for Medicaid long-term care programs.

CommunityChoice

Chapter 4 of 2004 required DHMH to establish a managed long-term care program to provide long-term care services to adults eligible for both Medicaid and Medicare, adult Medicaid recipients who meet the nursing home level-of-care standard, and Medicaid recipients over age 65. In response to the legislation, DHMH established the CommunityChoice advisory group to develop a waiver proposal for a managed long-term care program. However, in January 2007, DHMH learned that the federal government planned to deny the waiver. In the announcement of the decision to no longer pursue the CommunityChoice waiver, DHMH stated that the department was still committed to working with stakeholders “to achieve the goals enunciated by CommunityChoice.”

Ida Brown v. Department of Health and Mental Hygiene

In April 2005, Ida Brown applied for home- and community-based services under the Older Adults Waiver and was denied services due to DHMH's determination that she did not satisfy the standard for medical eligibility. DHMH's denial was upheld by the Office of Administrative Hearings but was reversed by the circuit court for Baltimore City. On appeal, the Court of Special Appeals held in *Ida Brown v. Department of Health and Mental Hygiene* that Maryland's medical eligibility standard for nursing facility level of care was more restrictive than the federal definition. In November 2008, the Court of Appeals affirmed the decision of the Court of Special Appeals.

DHMH Recent Actions

In fiscal 2009, DHMH is using \$17 million in funds originally appropriated for a nursing home rate increase to amend the Medicaid long-term care program in response to the *Ida Brown v. Department of Health and Mental Hygiene* decision. DHMH will use this funding to broaden the nursing facility level of care assessment and obtain a medical day care waiver.

Nursing Facility Level of Care

On July 1, 2008, DHMH sent out a transmittal amending the medical eligibility for nursing facility level of care. The amended guideline removes the requirement that an individual must require the direct involvement of a licensed health care professional to meet the nursing facility level of care standard. As a result, more individuals may become eligible for nursing home and home- and community-based services. However, at this time, individuals will have to enter into the more expensive option of nursing home services because the home- and community-based waivers are all filled to capacity.

Medical Day Care Waiver

The nursing facility level of care standard is linked to the eligibility of most home- and community-based waiver programs, the Programs of All-Inclusive Care for the Elderly program, and medical day care services. In April 2008, DHMH submitted a home- and community-based services waiver application for medical day care services to the Centers for Medicare and Medicaid Services. Medical day care services will no longer be provided through the Medicaid State Plan but will instead be provided under the waiver. Although, the new waiver allows for 1,000 additional medical day care slots, the waiver also allows DHMH to cap the number of slots, which it could not do under the State Plan.

Moving Forward

DHMH continues to state that long-term care reform is a priority, and the federal 2005 Deficit Reduction Act provides states with some new long-term care options. The following are options being implemented in other states to control the cost of long-term care services:

- **Expand or Enhance Home- and Community-based Services** – Providing services through a community-based setting rather than a nursing home facility is cost effective and preferred by Medicaid enrollees. For this reason, in fiscal 2008, a majority of states took action to expand their home- and community-based programs.
- **Cash and Counseling** – The 2005 Deficit Reduction Act permits states to allow for self-direction of personal assistance services without needing to get a waiver from the federal government. This type of self-direction is called cash and counseling, and it is a program that gives elderly and disabled Medicaid consumers the option of directing their own care.
- **Managed Long-term Care** – Several states are considering policy options to transfer certain Medicaid populations into managed care. Medicaid managed care programs would make both institutional and home- and community-based services available to enrollees, with services coordinated by a community care organization. The intent of managed care is to make a wider variety of services available with increased accountability at reduced cost. DHMH could build on reports from the Consumer Choice Advisory Group that included recommendations for establishing a managed care long-term care program in Medicaid.

Health and Health Insurance

Update on Medicaid Population and Financing Trends

Medicaid continues to be a major element of the State budget and one of its fastest growing segments. In fiscal 2009, there is an anticipated general fund deficiency of \$39.0 million. Expenditure growth in fiscal 2010 is anticipated to be almost 10 percent.

Overview

Maryland's Medical Assistance Programs (Medicaid and the Maryland Children's Health Program (MCHP)) provide eligible low-income individuals with comprehensive health care coverage. Funding is derived from both federal and State sources with a federal fund participation rate of 50 percent for Medicaid and 65 percent for MCHP. Last year, congressional efforts to reauthorize the State Children's Health Insurance Program (SCHIP) (which is the federal funding source for MCHP) failed, but a continuing resolution extended the program through March 31, 2009. President-elect Obama and congressional leadership have stated that reauthorizing and expanding SCHIP is a priority, so it is expected that MCHP will be funded at least at the current level after March 2009.

The budget for the Medical Assistance Programs accounts for almost 17.0 percent of State general fund expenditures and is one of the fastest growing segments of the State budget. Over the next five years, Medicaid costs are expected to rise at a rate of about 8.4 percent annually. Chapter 7 of the 2007 special session expanded Medicaid eligibility to adults with income up to 116 percent of the federal poverty level. See the separate Issue Paper "Health Care Reform: Maryland, Other States, and the President-elect" for a fuller description of the expansion.

Fiscal 2009 Outlook

The fiscal 2009 Medical Assistance budget of \$5.4 billion (\$2.3 billion of general funds) appears to be \$154.9 million (\$39.0 million in general funds) less than the anticipated need. The additional need for funding in fiscal 2009 is attributed to:

- higher than expected enrollment growth. The fiscal 2009 working appropriation is funded at a level that permits Medicaid and MCHP enrollments to increase by 0.6 percent. However, it is anticipated the enrollment for these programs will grow by 2.0 percent, which translates into the need for an additional \$79.5 million;
- a 5.5 percent calendar 2009 rate increase for the managed care organizations (\$39.1 million);

- ending hospital day limits as of July 1, 2008, with hospital assessment revenue. This additional expense is expected to cost \$32.4 million (\$16.2 million in special funds and \$16.2 million in federal funds);
- an additional 0.5 percent rate increase for community service providers, which brings their fiscal 2009 rate increase to 2.0 percent. The additional 0.5 percent increase amounts to \$1.5 million (\$0.7 million in special funds and \$0.7 million in federal funds);
- the Board of Public Works budget reductions removed \$9.0 million in general funds from the Medical Assistance budget. It is expected these funds will be backfilled with the Cigarette Restitution Funds through a special fund deficiency appropriation; and
- the administrative costs related to the Medicaid expansion to parents are not included in the fiscal 2009 working appropriation, and these costs are expected to amount to \$3.0 million.

These increased costs were somewhat offset by lower than anticipated inpatient hospital costs and lower than anticipated MCHP costs.

Expenditures for fiscal 2009 services are expected to exceed fiscal 2008 costs by about 8.8 percent due to medical inflation (5.0 percent), enrollment growth (2.0 percent), and the expansion of Medicaid benefits to parents with incomes up to 116.0 percent of the federal poverty level.

Fiscal 2010 Forecast

As shown in **Exhibit 1**, fiscal 2010 Medical Assistance expenditures are anticipated to be almost \$6.0 billion with general funds accounting for just over 40.0 percent of the total. Overall costs will increase by 9.6 percent while general fund spending is expected to grow by about \$174.5 million, or 7.5 percent, over the projected fiscal 2009 costs. Factors contributing to the anticipated expenditure growth include enrollment increases of almost 2.1 percent and changes in medical inflation/utilization (5.1 percent). The forecast also assumes the State will:

- **Continue to Expand Medicaid Coverage to Parents** – The fiscal 2010 expenditures for the expansion of Medicaid coverage to parents with income up to 116 percent of the federal poverty level is expected to increase by \$73.8 million (\$36.9 million in special funds and \$36.9 million in federal funds) due to annualization of the program.

Exhibit 1
Enrollment and Service Year Expenditures⁽¹⁾
Fiscal 2008-2010

	<u>2008</u> <u>Actual</u>	<u>2009</u> <u>Estimate</u>	<u>2010</u> <u>Estimate</u>	<u>2009-2010</u> <u>% Change</u>
Enrollment by Category				
Medicaid	531,635	540,865	550,456	1.8%
MCHP	108,504	112,368	116,402	3.6%
Expansion to Parents	0	36,420	38,075	4.5%
Expansion to Childless Adults	0	0	36,344	100.0%
Total	640,139	689,653	741,277	7.5%
Cost Per Enrollee ⁽²⁾	\$7,671	\$7,750	\$8,318	7.3%
Total Funds (\$ in Millions)	\$4,911	\$5,344	\$5,863	9.7%

MCHP: Maryland Children's Health Program

¹Expenditures by fiscal year are based on the cost of providing services during that fiscal year rather than the year that the bills were actually paid. Cases and funding associated with the Primary Adult Care Program, the Employed Individuals with Disabilities Program, and the Kidney Disease Program are excluded from the chart.

²Fiscal 2010 calculation for "cost per enrollee" does not include childless adults in the denominator because childless adults have a limited benefit package in fiscal 2010 that includes only specialty medical care and hospital emergency department services.

Source: Department of Legislative Services

- **Expand Medicaid Benefits to Childless Adults** – In fiscal 2010, statute provides that, to the extent funds are provided in the State budget, benefits for childless adults with incomes up to 116 percent of the federal poverty level will be eligible to receive specialty medical care and hospital emergency department services. This expansion of Medicaid benefits is expected to cost \$69.0 million (\$34.5 million in special funds and \$34.5 million in federal funds).
- **Enhance Physician Rates** – Chapter 5 of the 2004 special session and Chapter 1 of 2005 earmark revenue from the Rate Stabilization Fund toward enhancing physician rates. In fiscal 2010, the revenue from the Rate Stabilization Fund will allow for a \$20.5 million (\$10.3 million in special funds and \$10.3 million in federal funds) increase to physician rates.

- **Enhance Dental Reimbursement Rates** – Fiscal 2010 is the second year of a three-year phase-in of the Dental Action Committee’s recommendation to get Medicaid’s dental reimbursement rates up to the fiftieth percentile of the American Dental Association’s South Atlantic Region average reimbursement rate for all dental codes. This rate enhancement is anticipated to cost \$14.0 million.

Health and Health Insurance

Physician Availability

In 2007, the Maryland Hospital Association and the Maryland State Medical Society released a study projecting a severe shortage of physicians in Maryland. Two task forces have been studying issues relating to physician availability and will likely issue recommendations that will result in legislation.

Background

Some studies suggest that there is a nationwide shortage of physicians available to meet the increasing demands of today's health care environment. Projections over the next 10 years suggest a vast disparity between the needs of the health care industry and the availability of qualified physicians. In 2007, the Maryland Hospital Association (MHA) and the Maryland State Medical Society (MedChi) commissioned a study of Maryland's physician workforce. This paper will discuss the study's findings and give an overview of the work of two task forces that were formed to develop recommendations regarding the physician practice environment in the State.

MHA/MedChi Study

Study Findings

In 2007, MHA and MedChi commissioned a study of Maryland's physician workforce. The study breaks down the physician data by regions and key specialties to determine the areas of greatest need. Overall, the study found that:

- Maryland has 16 percent fewer physicians available for clinical practice than the national average.
- The most severe physician shortages (*i.e.*, where supply is significantly below the national average) are found in rural areas of the State including the Eastern Shore, Southern Maryland, and Western Maryland.
- Shortages are projected to worsen over the next 7 to 10 years.
- Gaps are most noticeable in primary care (including internal medicine, pediatrics, geriatrics, and family medicine), emergency medicine, anesthesiology, gastroenterology, hematology/oncology, general surgery, psychiatry, and dermatology.

Some of the factors driving these projections include:

- An aging physician population (33.4 percent of all clinical physicians are over 55 years old, and 9.9 percent are aged 65 or older);
- The number of residents trained in Maryland's hospitals opting to practice in this State is insufficient to replace retiring physicians (only 52 percent of residents will continue to practice in the State, with projections indicating that the number could fall to as low as 25 percent by 2015); and
- Current residents and fellows prefer to start medical careers as hospital employees or in large practice groups instead of the small private practices that are prevalent in the State.

The study was not without criticism. For example, the methodology used to determine the physician supply in the State has been questioned, as it makes physician supply comparisons between Maryland and other states difficult. However, there seems to be agreement even amongst critics of the study that physicians specializing in primary care specialties are in short supply in the State, particularly in rural areas.

Study Recommendations

In light of the findings of the study, MHA and MedChi made several policy recommendations to alleviate the problems, including:

- increasing physician reimbursement rates and pursuing medical liability initiatives to make the Maryland professional practice environment more competitive nationally;
- developing medical education loan forgiveness programs tailored to retain residents in critical need medical specialties, especially in practice areas with severe shortages; and
- sponsoring educational programs based on innovative practice models and structures, increasing the emphasis on information technology innovations, and boosting the number of residency slots to expand the pool of residents available to practice in the State.

Task Forces and Potential Recommendations

Task Force on Health Care Access and Reimbursement

The Task Force on Health Care Access and Reimbursement, chaired by the Secretary of Health and Mental Hygiene, is charged with examining reimbursement rates and total payments to physicians and other health care providers by specialty and geographic areas in Maryland, comparing these data to similar data in other states, and determining the impact of rates and payments on access to health care and other areas.

Potential recommendations that have been discussed by the task force to address the issue of physician shortages include the following:

- developing a loan forgiveness program for physicians specializing in primary care who agree to practice in the State in underserved areas for a certain duration;
- making medical practices eligible for participation in State technical assistance programs for businesses;
- facilitating entry into the Maryland market by streamlining credentialing requirements, for example, aligning State credentialing standards around the standard credentialing form developed by CAQH, a national nonprofit alliance of health plans and trade associations; and
- modifying the current law regarding payment to nonparticipating providers who provide covered services to enrollees of health maintenance organizations.

Task Force to Review Physician Shortages in Rural Areas

In the 2008 session, the General Assembly created another task force to address the shortage of physicians in the State: the Task Force to Review Physician Shortages in Rural Areas. This task force is recommending a multi-strategy approach to addressing the shortages of primary and specialty care shortages in Maryland's rural areas:

- In the short term, the task force is looking to recruit physicians from other states and foreign countries through addressing perceptions about Maryland's poor practice environment (including physician reimbursement rates and tort reform).
- In the intermediate term, the task force is looking to increase interest in practicing in rural areas through graduate medical education programs. This approach would require increasing the number of residencies in rural areas through increased funding for faculty and facilities in order to host residency programs and to provide debt relief for residents who make service commitments to practice in rural areas.
- The long-term approach includes establishing a "grow your own doctor" program. The task force discussed several successful programs in other states that target individuals earlier in their education for interest and ability to complete medical school or other health care careers. This solution includes guaranteeing spots in medical school for those interested in practicing in rural areas.

The task force is scheduled to submit its final report by December 1, 2008.

Conclusion

Recommendations from the MHA/MedChi study, the Task Force on Health Care Access and Reimbursement, and the Task Force to Review Physician Shortages in Rural Areas will likely result in legislation in the 2009 session to address the problem of the physician shortage, particularly in primary care specialties. However, at this point, the list of potential proposals has yet to be narrowed down or, perhaps more importantly given the State's fiscal condition, costed-out.

Social Programs

Public Assistance Population and Financing Trends

Worsening economic conditions are reflected in key welfare caseloads. The Temporary Cash Assistance caseload is estimated to increase 3.5 percent in 2009, while the Food Stamp caseload has been growing at an annual rate of 12.8 percent in the past two years.

Background

The deteriorating economic climate appears to be reflected in two key public assistance programs: Temporary Cash Assistance (TCA) and the Food Stamp Program. TCA provides monthly cash grants to needy children and their parents or caretaker relatives. The program is funded with general funds, federal Temporary Assistance for Needy Families (TANF) block grant dollars, and certain child support collections. The Food Stamp Program helps low-income people buy the food they need for good health. Benefits under the Food Stamp Program are provided entirely from federal funds.

TCA Caseload Trends

In the early years of welfare reform, efforts to transition individuals from welfare to work and a growing economy led to a rapid reduction in the number of TCA recipients. After dropping at rates exceeding 20.0 percent per year during the 1990s, the pace of caseload decline slowed considerably in the early years of this decade. With the recovering economy and the implementation of a universal engagement policy in fall 2003 – a policy that requires participation in activities such as up-front job search, orientation, assessment of employability, development of an Independence Plan, training, and subsidized employment – the caseload decline accelerated again, falling by 1.1 percent in fiscal 2004, 7.2 percent in fiscal 2005, 12.5 percent in fiscal 2006, and 12.9 percent in fiscal 2007. Deteriorating economic conditions reversed this trend and led to a 2.4 percent increase in the average monthly caseload in fiscal 2008.

Fiscal 2009 and 2010 Forecasts

As shown in **Exhibit 1**, the Department of Legislative Services (DLS) assumes that the TCA caseload will increase in fiscal 2009 with the average monthly enrollment rising to 53,358 and increase at a slower rate in fiscal 2010, reaching 53,892. This represents a 3.5 percent increase in fiscal 2009 and a 1.0 percent increase in fiscal 2010. These caseload projections assume the beginning of an economic recovery, forecast to begin in calendar 2010.

Exhibit 1
TCA Enrollment and Funding Trends
Fiscal 2008-2010

	<u>2008 Actual</u>	<u>2009 Approp.</u>	<u>2009 Estimate</u>	<u>2010 Estimate</u>	<u>2009-2010 % Change</u>
Average Monthly Enrollment	51,554	49,250	53,358	53,892	1.0%
Average Monthly Grant	\$170.39	\$185.56	\$186.91	\$191.57	2.5%
Funds in Millions					
General Funds	\$5.5	\$6.6	\$6.6	\$19.9	202.4%
Total Funds	\$104.2	\$105.4	\$119.7	\$123.9	3.5%

Source: Department of Human Resources; Department of Legislative Services

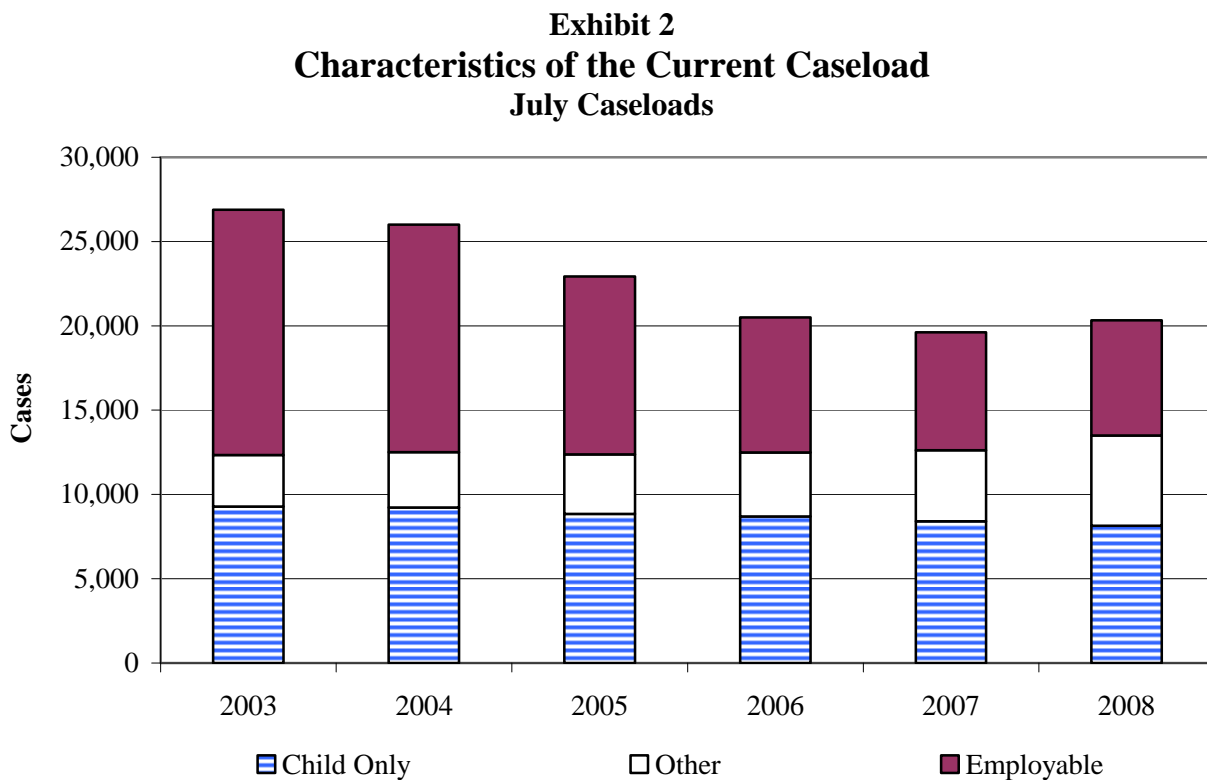
The fiscal 2009 TCA grant amounts remain unchanged from fiscal 2008 (the average monthly grant increases slightly reflecting the annualization of the grant increase put into effect the previous October) since the expected increase in the food stamp benefit was judged sufficient to maintain the combined TCA/food stamp benefit level at 61.0 percent of the Maryland Minimum Living Level. For fiscal 2010, DLS assumes an increase of 3.3 percent in the monthly grant amount beginning in October 2009, which is equal to the recent increase in the Maryland Minimum Living Level. This translates to an annual grant increase for fiscal 2010 of 2.5 percent.

General funds are projected to increase by \$19.9 million in fiscal 2010. This increase is necessitated by the expected exhaustion of the TANF balance in fiscal 2009.

Characteristics of the Current Caseload

To track recipients needing employment services, the Department of Human Resources (DHR) divides the caseload into two main groups: (1) the “core” caseload; and (2) cases headed by an employable adult. The core cases include child only cases, women with children under age one, disabled cases, caretaker relatives, and other cases exempted from work requirements. With the exception of women with children under age one, DHR does not expect the core cases to transition off cash assistance by seeking employment. Child only cases, for example, typically leave the rolls after reaching adulthood. As employable adults have successfully entered the labor market, the core cases have represented an increasing percentage of the total TCA caseload. As shown in **Exhibit 2**, while the total caseloads have declined since 2003, the nonemployable core caseload has remained virtually the same. As a result, the nonemployable core caseload – as a percent of total caseload – has increased from just under 46 percent in 2003

to 66 percent in 2008. The employable caseload declined from just over 54 percent in 2003 to 34 percent in 2008.



Note: “Other” category includes Child Under One, Relative Caretaker, Disabled, and Other Exemptions; caseload numbers differ from enrollment in that cases often involve more than one person.

Source: Department of Human Resources; Department of Legislative Services

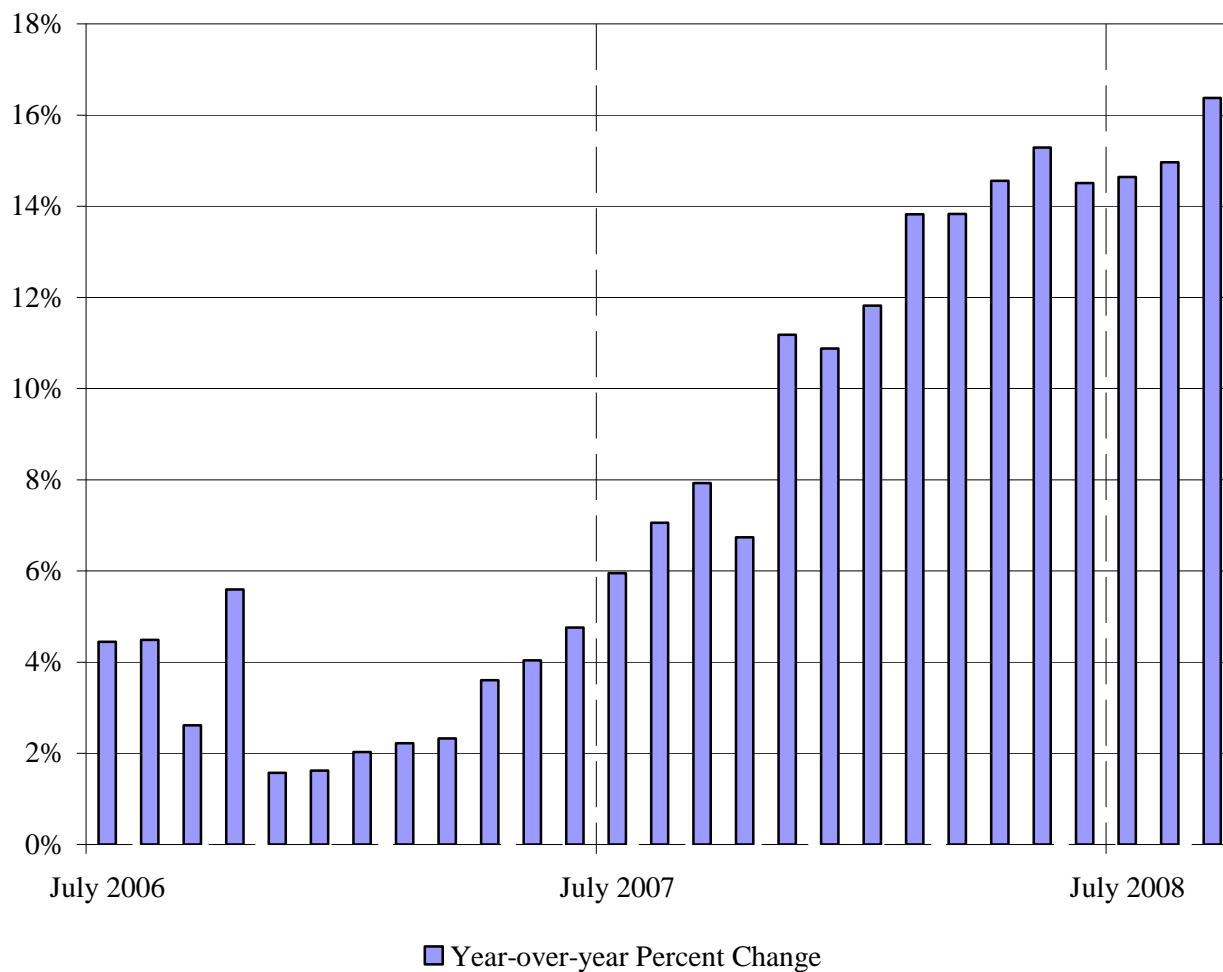
In the early years of welfare reform, DHR concentrated on serving those easiest to place in employment. Through its successful efforts, most of these cases have transitioned from welfare to work. At this time, the remaining cases headed by an employable adult typically face multiple barriers to employment such as substance abuse and/or mental health issues, poor work histories, low educational attainment, and limited access to transportation and child care. To realize further caseload reductions, DHR must continue to provide intensive services to help these employable adults enter and remain in the labor force.

Food Stamp Caseload Trends

The worsening economic climate, combined with increased outreach efforts, has led to steady increases in the number of food stamp recipients over the past two years. As shown in **Exhibit 3**, the caseload has been growing at an increasing rate. In July 2006 there were 306,002

people receiving food stamp assistance. By September 2008 this number had grown to 389,298. This 100 percent federally funded benefit resulted in almost \$410 million in spending in Maryland in fiscal 2008.

Exhibit 3
Food Stamp Caseloads
July 2006 – September 2008



Source: Department of Human Resources; Department of Legislative Services

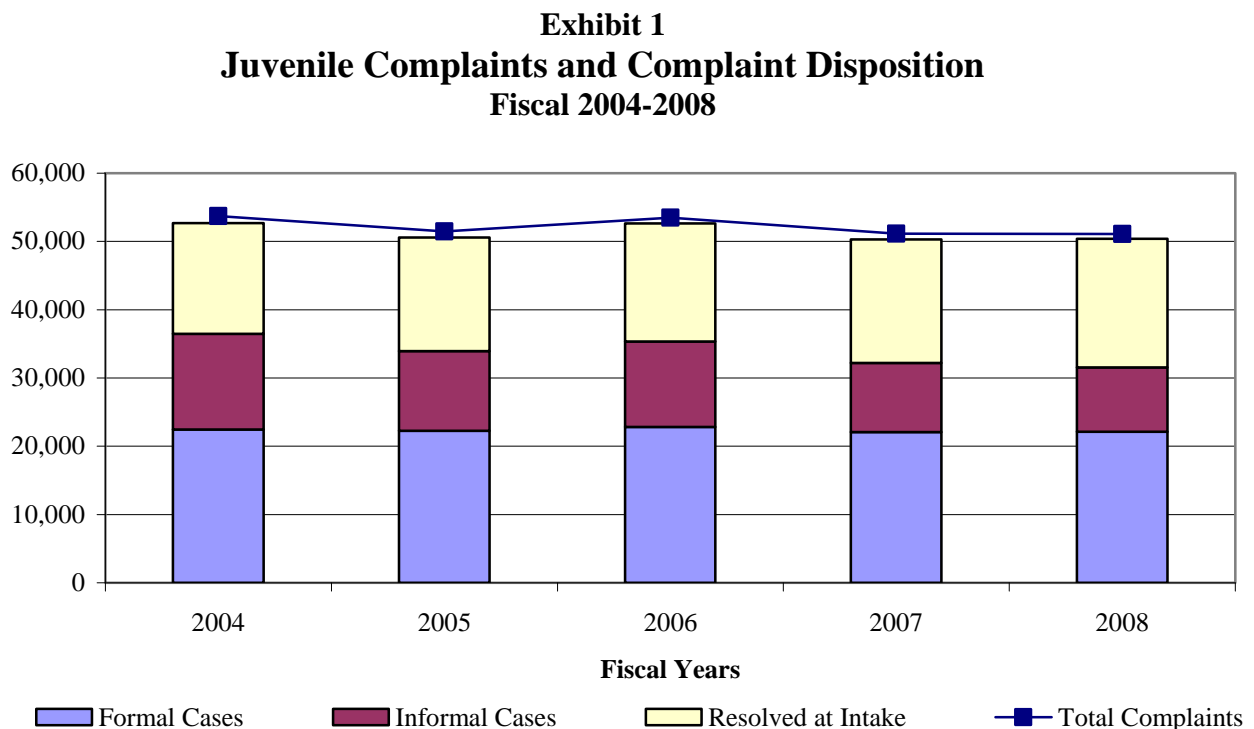
Social Programs

Department of Juvenile Services Population and Financing Trends

The total number of complaints handled by the Department of Juvenile Services is at the lowest level in years. Similarly, the number of youth served in pre- and post-disposition residential placements continues to fall. At the same time, the department continues to face significant budget challenges.

Population Trends

Exhibit 1 details the total number of complaints received by the Department of Juvenile Services (DJS) in recent years, as well as the disposition of those complaints.



Note: Total complaints typically are 1 to 2 percent higher than the sum of those resolved at intake and the informal and formal caseload. The difference relates to cases with jurisdictional issues or in which a decision is not recorded.

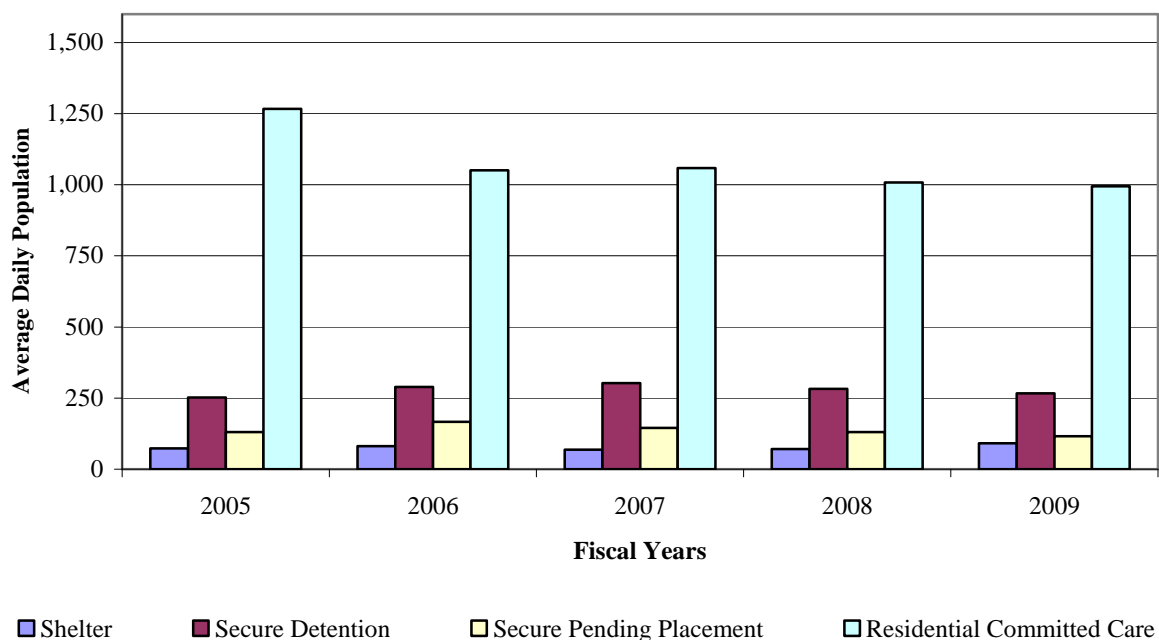
Source: Department of Juvenile Services

As shown in the exhibit:

- The total number of complaints received in fiscal 2008, just over 51,000, is the lowest number for the period shown, although is virtually unchanged from fiscal 2007.
- Formal caseloads, those cases where DJS believes court intervention is required, actually increased slightly (0.2 percent) from fiscal 2007 to 2008. Over the period shown, regardless of the actual number of complaints, the formal caseload has remained between 42.0 and 43.0 percent of total case dispositions.
- Cases resolved at intake continue to increase in real and relative terms, a trend that has been true for the entire decade. For example, cases resolved at intake increased by 4.1 percent in fiscal 2008 over fiscal 2007. Conversely, those cases that are considered to require some form of intervention but do not rise to the level of court intervention (the informal caseload) continue to fall both numerically (6.6 percent from fiscal 2007 to 2008) and as a percentage of total complaints.

In terms of the youth that require out-of-home placements, **Exhibit 2** illustrates that recent downward trends in pre- and post-disposition residential placements continue.

Exhibit 2
Selected Average Daily Population Trends
Department of Juvenile Services
Fiscal 2005-2009 (YTD)



Source: Department of Juvenile Services

Specific trends identified in the exhibit include:

- An ongoing drop in the utilization of secure detention facilities for both pre-disposition youth as well as post-disposition youth held in those facilities pending a permanent residential placement.
- The decline in the secure pending placement population (11 percent in fiscal 2009 year-to-date over fiscal 2008) appears to have been achieved primarily by the utilization of increased shelter care (a 28 percent increase in fiscal 2009 year-to-date over fiscal 2008 and almost exclusively utilized by youth pending placement).
- The average daily population (ADP) of youth in committed residential placements is slightly lower in fiscal 2009 year-to-date compared to fiscal 2008, at just under 1,000 youth. Although, this number is significantly lower than that shown for fiscal 2005 when the ADP was 1,267, most of this decline occurred between fiscal 2005 and 2006.

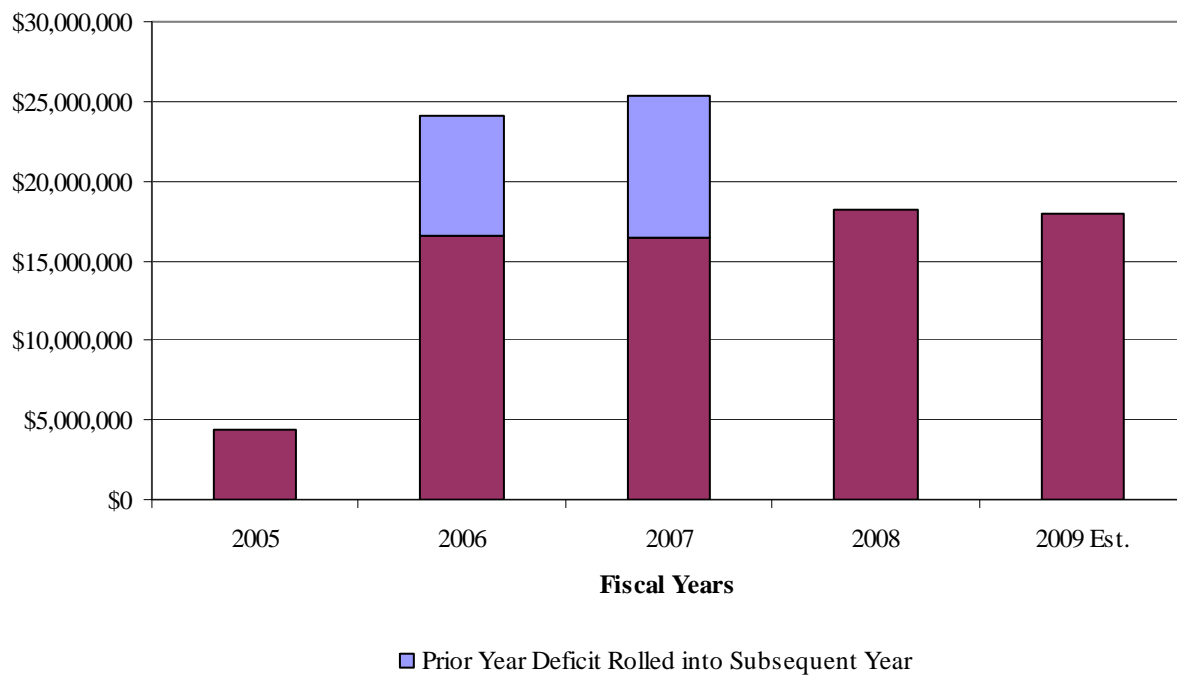
While the ADP of youth in committed residential placements is relatively unchanged in fiscal 2009 year-to-date, there has been a shift in who is providing services. With the re-opening of Victor Cullen as a State-operated facility, more youth are being served at State-operated facilities at the expense of private per diem providers. More change in terms of service provision is anticipated in fiscal 2009 with the recently announced closure of the O'Farrell Center, a State-owned but contractually operated facility.

Financing Trends

Despite handling fewer complaints and serving fewer youth in its deep-end (and more expensive) pre- and post-disposition residential placements, the department's budget problems continue. Although, as shown in **Exhibit 3**, DJS did not report any need to roll fiscal 2008 deficits into fiscal 2009, preliminary analysis of expenditure patterns reveals significant expected deficiencies in fiscal 2009. The two principal areas of anticipated deficiencies are:

- Regular and contractual staffing at State-operated facilities. Despite falling populations, overtime levels at many DJS facilities, as well as the use of contractual staff, particularly at the detention facilities, are projected to be much higher than budgeted. This higher level of staffing is considered by DJS to be required to maintain proper oversight and programming at those facilities.
- Residential per diem placements. Despite the declining use of residential per diem placements, the department appears to be running deficits in this programming, as it has for several years. The extent of the deficit in this program could be made worse by a recent communication from the federal government indicating that DJS is ineligible to claim Title IV-E funds. While a declining funding source in recent years, DJS was still anticipating claiming \$5 million in federal IV-E funds in fiscal 2009.

Exhibit 3
General Fund Deficiencies
Department of Juvenile Services
Fiscal 2005 to Estimated Fiscal 2009



Source: Department of Legislative Services

Social Programs

Privatization of Child Support Operations

As the State contemplates another extension of the Child Support Enforcement Privatization project, data comparing the two jurisdictions with privatized programs to other jurisdictions with different program models show mixed results.

Background

The Child Support Enforcement Privatization Pilot Project within the Department of Human Resources (DHR) began as a result of Chapter 491 of 1995. The privatized sites were Baltimore City and Queen Anne's County. This legislation also created the first demonstration site in Washington County. The demonstration site was to compete against the two privatized sites. As a demonstration site, a jurisdiction is provided management flexibility, such as special appointment status for employees and the potential for employee bonuses for performance in several areas.

The privatization pilot project was reauthorized several times through legislation (Chapter 486 of 1999, Chapter 439 of 2002, and Chapters 312 and 392 of 2003). Under the most recent authorization, the privatization pilot ends September 30, 2009. That same legislation also required all jurisdictions that are not privatized to become demonstration sites by July 1, 2008, on a phased-in schedule. The final jurisdiction became a demonstration site on July 1, 2008.

Comparison of Performance

So how have the privatized and demonstration offices performed? The following analysis compares the performance of the two privatized sites under the current contract that began January 2004 to the eight jurisdictions (Allegany, Anne Arundel, Baltimore, Carroll, Charles, Dorchester, Frederick, and Prince George's counties) that became demonstration sites on July 1, 2005, and the three jurisdictions (Kent, St. Mary's, and Wicomico counties) that became demonstration sites only after the time period for which data was provided by DHR.

Performance of child support enforcement can be measured in several ways, including total collections, cost effectiveness, percent of cases with a support order, percent of cases with paternity established, percent of current support paid, and percent of cases paying on arrears. In this paper, detail is provided on two of those measures, the percent of current support paid and the percent of cases paying on arrears, during the period of federal fiscal 2005 to 2007.

As shown in **Exhibit 1**, the performance of the privatized jurisdictions was mixed compared to other jurisdictions between federal fiscal 2005 and 2007 in terms of the percent of current support paid. Queen Anne's County performed better than six of the comparison demonstration sites and all three nondemonstration sites during this time period despite beginning the comparison period already having a high percentage of current support paid. Baltimore City, despite starting the period as a low performer in this category, performed better than only two of the demonstration sites, and its overall performance decreased. Nonetheless, the city did perform better than two of the nondemonstration sites.

Exhibit 1
Comparison of Child Support Performance
Federal Fiscal 2005-2007

<u>Jurisdiction</u>	Current Support Paid			Cases Paying on Arrears		
	<u>2005</u>	<u>2007</u>	<u>Annual Change 2005-2007</u>	<u>2005</u>	<u>2007</u>	<u>Annual Change 2005-2007</u>
Baltimore City	49.63%	49.32%	-0.31%	50.63%	47.97%	-2.66%
Queen Anne's	66.55%	67.62%	0.80%	72.94%	69.23%	-2.58%
Allegany	70.31%	71.02%	0.50%	74.66%	77.40%	1.82%
Anne Arundel	63.18%	66.02%	2.22%	70.74%	70.41%	-0.23%
Baltimore Co.	65.89%	66.91%	0.77%	71.36%	71.40%	0.03%
Carroll	71.36%	70.61%	-0.53%	76.69%	75.16%	-1.00%
Charles	68.18%	67.90%	-0.21%	78.66%	75.20%	-2.22%
Dorchester	58.92%	58.70%	-0.19%	67.07%	66.49%	-0.43%
Frederick	70.53%	68.04%	-1.78%	75.45%	74.84%	-0.41%
Prince George's	65.21%	67.08%	1.42%	65.03%	64.00%	-0.80%
<i>Kent</i>	66.55%	65.00%	-1.17%	76.62%	73.13%	-2.30%
<i>St. Mary's</i>	68.10%	69.02%	0.67%	72.24%	71.36%	-0.61%
<i>Wicomico</i>	60.05%	59.21%	-0.70%	63.56%	60.95%	-2.07%
State	63.08%	63.77%	0.55%	63.92%	62.26%	-1.31%

Note: Demonstration sites began July 1, 2005 (federal fiscal 2005). The new contract began January 2004 (federal fiscal 2004). Calculation for current support paid: total current support distributed year-to-date/total current support due year-to-date. Calculation for cases paying on arrears: total IV-D cases paying arrears/total IV-D cases with arrears. IV-D cases are child support cases enforced by the State's Child Support Enforcement Administration.

Source: Department of Human Resources; Department of Legislative Services

However, as also shown in Exhibit 1, the two privatized sites performed worse compared to the demonstration and nondemonstration sites between federal fiscal 2005 and 2007 in terms of the percent of cases in arrears that are actually making progress on those arrearages. Both jurisdictions, as did most other jurisdictions, experienced overall declines in performance.

Future Action

Due to the impending sunset of the authorization for the privatization pilot, legislation is likely to be introduced in the 2009 session regarding the continuation of this project. As shown above, and as also borne out in the other available performance data, the privatized jurisdictions have not proven superior to other models of administration under the pilot programs.

Social Programs

Energy Assistance Funding

Increasing energy costs combined with the deteriorating economic climate have led to an increasing demand for energy assistance. Applications in fiscal 2008 increased over the prior year by over 15 percent for the Electric Universal Services Program (EUSP) and by over 13 percent for the Maryland Energy Assistance Program. Increased federal Low-Income Home Energy Program funding may obviate the need for a fiscal 2009 deficiency appropriation for EUSP.

Maryland's Energy Assistance Programs

The Department of Human Resources (DHR) administers two energy assistance programs:

- the Electric Universal Services Program (EUSP) which provides assistance to households in paying electric bills and is funded with State general funds and special funds from fees imposed on commercial, industrial, and residential ratepayers; and
- the Maryland Energy Assistance Program (MEAP) which provides assistance with home heating bills using a variety of fuels and is funded with federal Low-Income Home Energy Assistance Program (LIHEAP) dollars.

Recent electricity rate increases and higher energy costs generally, combined with the deterioration in the economy have led to an increasing demand for energy assistance. In fiscal 2008 there were 117,220 applications to EUSP representing a 15.1 percent increase over the prior year. For MEAP there were 124,634 applications in fiscal 2008, a 13.4 percent increase over the prior year.

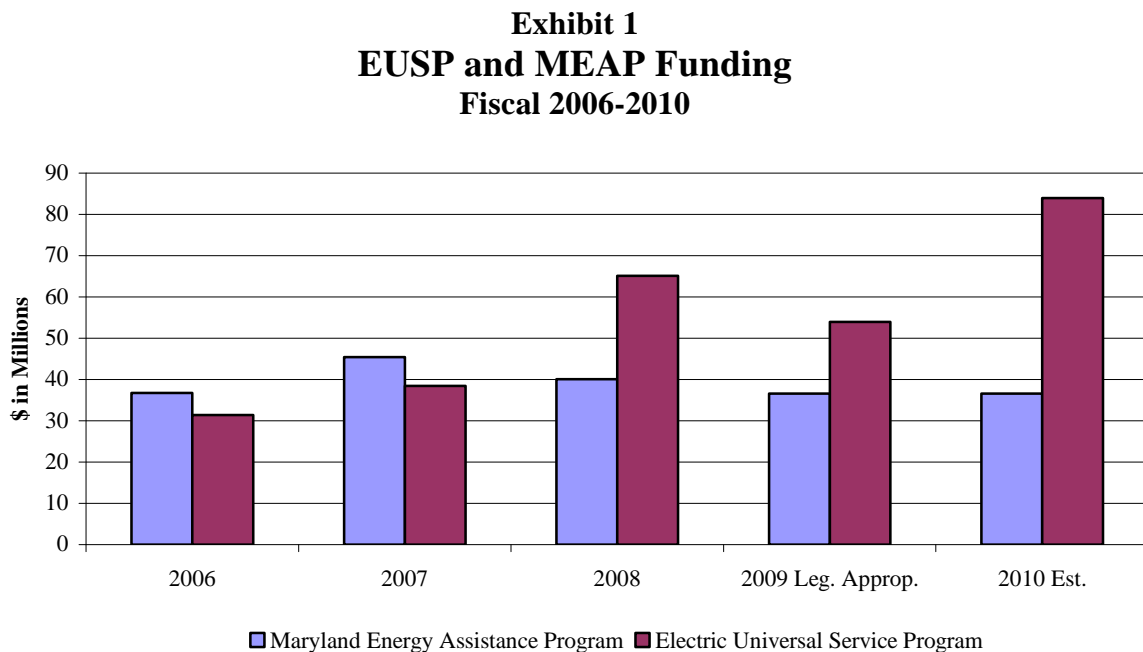
In the past, the only funding source for EUSP was special funds from fees imposed on commercial, industrial, and residential ratepayers. During the 2006 special session, the General Assembly increased the amount collected from ratepayers from \$34.0 million to \$37.0 million. Also, during the fiscal 2007 budget process, \$36.0 million in general funds and Energy Overcharge Restitution Fund (EORF)¹ funds were put into the State's Dedicated Purpose Account to augment the energy assistance budget as needed in the following years. The Dedicated Purpose funding was exhausted in fiscal 2008 and additional general funds were added to fiscal 2008 as a deficiency appropriation during the 2008 session. For fiscal 2009, \$21.7 million general funds were appropriated to supplement the funding from

¹ The Maryland Energy Administration administers the EORF, which is composed of federal court settlement monies from oil and gas producers that have violated federal regulations.

ratepayers. Beginning in fiscal 2009, special funds from RGGI carbon credit auctions will be available – \$2.8 million will be provided for electricity assistance programs as a result of the first quarterly auction held in September 2008, as 17 percent of the funding goes toward this purpose. A \$30.0 million deficiency appropriation for EUSP, consisting of \$19.1 million in general funds and \$10.9 million in special funds from RGGI auctions is expected in fiscal 2009.

MEAP funding levels have depended on the federal allocation of LIHEAP dollars. The federal fiscal 2009 appropriation for LIHEAP is more than double previous levels. It is expected that up to \$109 million will be brought into the budget primarily in fiscal 2009, although up to 10 percent may be carried over into fiscal 2010. DHR is exploring the possibility of using a portion of these federal funds to cover cooling costs which have in the past only been subsidized through EUSP. The ability to use LIHEAP funding for home cooling costs could eliminate the need for the fiscal 2009 general fund deficiency appropriation for EUSP.

Exhibit 1 shows the funding for the energy assistance programs for fiscal 2006 through 2010. It includes neither the increased MEAP funding nor the expected EUSP deficiency appropriation for fiscal 2009. A workgroup consisting of legislators from the Senate Finance Committee and the House Economic Matters Committee will meet in late November to discuss the adequacy of current low-income assistance efforts and consider changes to the current law.



Source: Department of Legislative Services

Transportation

Major Changes in the Draft *Consolidated Transportation Program*

The Maryland Department of Transportation's draft 2009 *Consolidated Transportation Program* (CTP) lists all capital projects funded in the current fiscal year and those planned for the next five years. The 2009 draft CTP totals \$9.4 billion, a \$1.2 billion decrease from the 2008 CTP due to downward revisions in revenues.

Overview

The Maryland Department of Transportation (MDOT) publishes an annual *Consolidated Transportation Program* (CTP) that lists all transportation capital projects funded in the current fiscal year and those planned for the next five years. **Exhibit 1** compares last year's six-year program with the six-year program contained in the draft 2009 CTP.

Exhibit 1 Comparison of Proposed Capital Program (\$ in Millions)

	2008-2013 CTP	2009-2014 Draft CTP	<u>Change</u>	<u>Percent Change</u>
State Funds				
Special Funds	\$6,818.9	\$5,805.6	\$-1,013.3	-14.9%
Other Funds *	834.8	835.0	0.0	0.0%
<i>Subtotal State Funds</i>	<i>\$7,653.7</i>	<i>\$6,640.6</i>	<i>\$-1,013.3</i>	<i>-3.1%</i>
 Federal Aid	 2,944.9	 2,747.4	 -197.5	 -6.7%
 Total Funds	 \$10,598.6	 \$9,388.0	 \$-1,210.6	 -11.4%

* Other funds include funds from the Maryland Transportation Authority, customer and passenger facility charges, and certain types of federal aid that do not pass through the Transportation Trust Fund.

Source: Maryland Department of Transportation, 2009 Draft *Consolidated Transportation Program*

The total funding level in the 2009 six-year program decreases by approximately \$1.2 billion (11.4 percent) from the six-year funding level in the 2008 CTP. The decline in funding is due to the following:

- ongoing weakness in the economy resulting in downward revisions to revenue estimates, in particular the titling and motor fuel tax;
- the reduction during the 2008 session from 6.5 to 5.3 percent in the distribution of sales tax revenues;
- conservative estimates of federal funding due to a forecasted funding shortfall.

As a result of the downturn in revenues, MDOT has had to defer, delay, and remove a number of projects from the capital program. Most of the projects affected by the downturn in revenues were projects added as a result of the revenue increase passed during the 2007 special session. As a result of the revenue increase, the State Highway Administration (SHA) and the Maryland Transit Administration (MTA) experienced the largest addition of new projects; accordingly, they have had the largest reductions to their capital programs. Specifically, SHA's capital program has decreased by \$916.1 million, and MTA's capital program has decreased by \$270.8 million.

Summary of Major Changes

As shown in **Exhibit 2**, projects totaling \$33.8 million were added to the construction program, and \$415.3 million in SHA projects were moved from the construction program to the development and evaluation program. Several other projects had funding delayed or deferred until later fiscal years.

Exhibit 2 Major Changes in the 2009-2014 Consolidated Transportation Program (\$ in Millions)

<u>Projects Added to the Construction Program</u>		<u>Cost</u>
MAA	Airfield Pavement Improvement Program Phase II at the Baltimore/Washington Thurgood Marshall International Airport	\$19.8
SHA	MD 36, Lower George's Creek Road; Replace Bridge 1014 (Allegany)	7.4
SHA	US 1, Belair Road; Replace Bridge Over Little Gunpowder Falls (Baltimore)	16.6
Total		\$33.8

Exhibit 2 (continued)

<u>Projects Moved from the Construction Program to the D&E Program</u>		<u>Costs</u>
SHA	US 40, Pulaski Highway, Middle River Road to MD 43 Interchange (Baltimore)	-\$8.8
SHA	MD 404, Shore Highway; Upgrade MD 404 from Tuckahoe Road to MD 480 (Caroline)	-19.9
SHA	MD 331, Dover Road; Replace Bridge over Choptank River (Talbot, Caroline)	-40.8
SHA	I-70, Baltimore National Pike; I-70, Phase 2D (Frederick)	-51.9
SHA	US 219 Relocated, Oakland Bypass; US 219 Relocated Bypass (Garrett)	-33.7
SHA	US 29, Columbia Pike; Seneca Drive to MD 175 (Howard)	-50.3
SHA	MD 32, Patuxent Freeway; Wellworth Way Access Improvements (Howard)	-8.9
SHA	MD 32, Patuxent Freeway; Interchange at Linden Church Road (Howard)	-11.3
SHA	MD 4, Pennsylvania Avenue; Interchange at Suitland Parkway (Prince George's)	-108.1
SHA	I-95/I-495, Capital Beltway; Improve Access from MD 5 and I-95/495 to Branch Avenue Metro (Phase II) (Prince George's)	-69.6
SHA	I-95/I-495, Capital Beltway; Access to Greenbelt Metro Station (Prince George's)	-8.0
SHA	MD 822, University of Maryland Eastern Shore Access Road; Construct Roundabouts at MD 675 (Somerset)	-4.0
Total		-\$415.3

MAA: Maryland Aviation Administration

SHA: State Highway Administration

D&E: Development and Evaluation

Source: Maryland Department of Transportation, 2009 Draft *Consolidated Transportation Program*

Transportation

Future Federal Transportation Funding Uncertain

The federal government recently announced a decrease in federal transportation aid to states to address the current funding shortfall in the federal Highway Trust Fund. Although Congress has acted to keep the fund solvent in fiscal 2009, the long-term solvency of the fund and its impact on Maryland remains uncertain.

Overview

On September 5, 2008, the U.S. Department of Transportation announced that aid disbursements to states would be rationed due to a funding shortfall in the Highway Trust Fund (HTF). A short-term fix through fiscal 2009 was passed by Congress. However, the long-term solvency of the HTF and funding programs will again be addressed next year as Congress must pass a six-year transportation funding authorization bill before September 30, 2009. The outcome of that debate could have important impacts for transportation funding in Maryland.

Background on Federal Funding

Federal transportation aid is predominantly derived from an 18.4-cent gasoline and 24.4-cent diesel tax. Revenues are deposited into the HTF and then distributed to states for highway and transit spending. Funding levels are set in a six-year authorization bill with the current authorization expiring after federal fiscal 2009. Under the current authorization, the Safe, Accountable, Flexible, Efficient, Transportation Equity Act: A Legacy for Users (SAFETEA-LU), Maryland is expected to receive average annual funding of \$720 million (\$580 million for highways and \$140 million for transit).

Funding Shortfall in the Highway Trust Fund

From 1996 to 2000, receipts to the HTF exceeded outlays, resulting in a significant fund balance. The past two authorizations have set the level of obligations above the level of receipts to draw down the fund balance. Due to this higher level of spending, as well as stagnant revenue growth, the President's Office of Management and Budget and the Congressional Budget Office (CBO) projected that the highway portion of the HTF would have a negative cash balance late in federal fiscal 2009. However, federal law requires the HTF to maintain a positive cash balance to ensure all prior obligations of funds can be met. Therefore, it was anticipated that either additional revenue would be needed to maintain current levels of spending or federal transportation aid to states would need to be reduced.

The announcement of the shortfall in fiscal 2009 occurred sooner than anticipated. To address the shortfall, Congress transferred \$8 billion from the federal general fund to keep the

HTF solvent through fiscal 2009. Given the recent declines in vehicle miles traveled and ongoing economic weakness, it will bear watching to see if the fix is sufficient.

Issues for the Upcoming Transportation Authorization

The debate on the next transportation authorization is likely to focus on how the HTF is funded and how funds are distributed given the funding shortfall. Specifically:

- How much should be made available for federal transportation funding? – To maintain current funding levels, revenues to the HTF will need to be increased. An increase in the gas tax, the main funding source for the HTF, is politically unpopular, and other revenue sources are still being debated. If expenditures are reduced to meet current revenue levels, CBO indicated in January that a 20 percent reduction in spending levels would be needed, which would mean a \$145 million annual reduction in federal aid for Maryland.
- How should transportation be financed? – In lieu of tax increases, alternative means to financing transportation infrastructure have been suggested, including increasing the use of toll roads, utilizing private sector investment through public-private partnerships, or eliminating the gas tax and replacing it with a vehicle miles traveled fee.
- How should transportation funds be used? – There is concern that current funding programs, which cover a wide variety of uses, do not adequately address the current needs for transportation investment and are not linked to national performance measures. Alternative funding proposals have focused on concentrating funding for transit programs, intercity rail, urban areas where congestion is highest, system preservation, and projects that move freight and goods.

With significant issues to discuss, as well as a late start due to the election, it is unlikely that a new authorization will be in place before the current one expires. Due to the HTF funding shortfall, freezing current spending levels under a continuing resolution, as has been done in the past, is not feasible unless a short-term solution is identified or funding levels are reduced.

Conclusion

Due to the funding shortfall and increasing demands for investment, there are short- and long-term concerns and uncertainty regarding how transportation is financed and federal aid is distributed to states. The breadth of issues to be confronted will force federal policymakers into a much broader policy and funding debate than in prior authorizations. Maryland's share of future federal aid and how those funds may be used will likely be different under the next authorization compared to prior authorizations.

Transportation

InterCounty Connector

The InterCounty Connector (ICC) project remains on schedule but has exceeded its budget, prompting the indefinite deferral of improvements along I-95 originally planned. An October 2008 action by the Board of Public Works reduced the fiscal 2009 general fund payment for the ICC by \$20.0 million; as a result, legislation will need to be introduced during the 2009 session to alter the general fund payment schedule.

Background

The InterCounty Connector (ICC) is an 18.8 mile, controlled access highway with accommodations for express bus service connecting the I-270/I-370 corridor in Montgomery County with the I-95/US 1 corridor in Prince George's County. The ICC will be owned and operated by the Maryland Transportation Authority (MDTA). The State Highway Administration (SHA), acting on behalf of MDTA, is managing the planning, environmental approvals, design, and construction administration.

The six-lane (three each way) highway will be the State's first fully electronic toll facility. There will not be any cash transactions or tollbooths, and all toll transactions must be made using either an E-ZPass transponder or video tolling, in which an image of the vehicle's license plate is captured and the vehicle's owner is mailed a bill. Toll rates for the facility have not yet been established; however, the ICC will be the first facility in Maryland to utilize congestion pricing, where toll rates vary based on time of day.

Funding

Chapters 471 and 472 of 2005 established a financing plan for the ICC based on an estimated project cost of approximately \$2.4 billion. The financing plan includes:

- approximately \$1.2 billion from MDTA cash, toll revenue bonds and/or a Transportation Infrastructure Finance and Innovation Act (TIFIA) loan;
- \$750.0 million in Grant Anticipation Revenue Vehicle (GARVEE) bonds;
- \$264.9 million from the State's general fund;
- \$180.0 million from the Transportation Trust Fund; and
- \$18.9 million from federal funds.

In June 2007, MDTA issued \$325.0 million of GARVEE bonds and achieved a net premium of \$16.9 million. A second issuance of \$425.0 million, scheduled for September 2008, was delayed as the result of uncertainty in the solvency of the federal Highway Trust Fund, which provides for repayment of the bonds, and turmoil in the bond market. MDTA hopes to move forward on this issuance by the end of 2008.

Chapter 567 of 2008 altered the timing of payments from the general fund to MDTA; however, it did not change the total amount of funding provided by the general fund. On October 15, 2008, in order to address a budget deficit, the Governor withdrew \$20.0 million from the fiscal 2009 appropriation to MDTA for the ICC through the Board of Public Works (BPW). Since the timing and amounts of general fund payments are established in statute, the Administration plans to propose legislation during the 2009 session to alter the payment schedule to redistribute the \$20.0 million withdrawn appropriation to fiscal 2010 and 2011. **Exhibit 1** shows the original general fund payment schedule provided in Chapters 471 and 472 of 2005, the changes made during the 2008 session, and the Administration's proposed changes to address the fiscal 2009 general fund payment reduced through BPW.

Exhibit 1
General Fund Payments for the ICC

<u>FY</u>	<u>Original Finance Plan</u>	<u>2008 Session Changes</u>	<u>Proposed Changes</u>
2007	At least \$50.0 million	\$53.0 million	\$53.0 million
2008	At least \$50.0 million	0	0
2009	At least \$50.0 million	\$85.0 million	\$65.0 million
2010	Balance to be repaid ¹	\$63.0 million	\$73.0 million
2011		\$63.9 million	\$73.9 million

ICC: InterCounty Connector

¹ Chapter 203 of 2003 transferred \$314.9 million from the Transportation Trust Fund to the general fund to address a budget shortfall. After a repayment of \$50.0 million in fiscal 2006, Chapters 471 and 472 of 2005 directed that the remaining balance of \$264.9 million be paid to the Maryland Transportation Authority for construction of the ICC. If payments of \$50.0 million had been made in fiscal 2007 through 2009, the balance to be repaid in fiscal 2010 would have been \$114.9 million.

Source: Department of Legislative Services

Project Cost and Schedule

Double-digit inflation in the cost of construction materials, such as fuel, cement, and steel, has caused construction costs for the ICC to increase by \$247.0 million over the past two years. These cost increases were somewhat mitigated by \$144.0 million in right-of-way savings

and the \$16.9 million premium realized from the first GARVEE bond issuance. The total cost of the project has increased to nearly \$2.6 billion; however, in order to mitigate cost increases, Contract D has been indefinitely deferred. Contract D includes improvements along I-95 adjacent to the ICC/I-95 interchange and is not essential to toll operations on the ICC. Excluding Contract D, the project remains on schedule to be completed in late 2011.

Exhibit 2 provides information on the cost of each contract based on the most recent estimates available, the change in cost from the 2007 estimates, and the status of each contract. Also included are estimated right-of-way and non-contract costs.

Exhibit 2
ICC Design-Build Contract Costs and Status
(\$ in Millions)

<u>Contract</u>	<u>Project Component</u>	<u>2008 Estimate</u>	<u>2007 Estimate</u>	<u>Change</u>	<u>Status</u>
A	I-270 to MD 97	\$508	\$508	\$0	Under construction
B	MD 97 to US 29	597	472	125	Bid protest
C	US 29 to I-95	546	562	(16)	Under construction
D	I-95 improvements	98	79	19	Indefinitely deferred
E	I-95 to US 1	75	61	14	NTP June 2009
ROW	Right-of-way	298	330	(32)	Ongoing
Other	Non-contract costs ¹	444	434	10	Ongoing
Total		\$2,566	\$2,446	\$120	

ICC: InterCounty Connector

NTP: Notice to Proceed

ROW: Right-of-way

¹ Non-contract costs include State Highway Administration project planning, preliminary engineering, and program management; utilities; park and ride facilities; open road toll equipment; intelligent transportation systems; maintenance/operations facilities; transit; and environmental mitigation costs.

Source: Maryland Transportation Authority, Department of Legislative Services

Transportation

REAL-ID Act Update

The issuance of final federal regulations implementing the REAL-ID Act, as well as a related report by the Motor Vehicle Administration, provide a context for how the General Assembly may respond to the federal REAL-ID requirements. Significant issues include the State's implementation costs and legal presence as a requirement for issuance of a driver's license or personal identification card.

Background

On May 11, 2005, President George W. Bush signed into law the federal REAL-ID Act. The Act requires federal agencies to accept only a driver's license or personal identification (ID) card that complies with the Act for official purposes (*e.g.*, boarding aircraft or entering federal facilities). The Act contains provisions establishing broad requirements for the composition and issuance of compliant ID cards and the development of information technology systems to enhance document authentication (including driver's licenses) and data verification capabilities.

The Act does not, in the strictest sense, impose federal standards on the states with respect to the issuance of ID cards. A state may choose to issue noncompliant ID cards under the Act and, unlike some federal requirements, there is no provision to penalize a state's noncompliance with the loss of federal funds.

The core standard for compliance with the Act requires a state to verify the identity and lawful presence of an applicant before the state issues an ID card. A state must also verify the validity and completeness of (1) a photo ID document or nonphoto document containing both the individual's full legal name and date of birth; (2) date of birth; (3) proof of a Social Security number or verification of ineligibility for a Social Security number; and (4) name and address of the individual's principal residence. The Act applies to both newly issued ID cards and renewals.

A state is further required to maintain a motor vehicle database that at least contains all data fields printed on the ID card and all motor vehicle driver histories, and to provide access to the database to all other states. Finally, a state must conduct a background check on any employee who is involved in the production of a compliant ID card or who has the ability to affect data fields associated with the ID card.

The Department of Homeland Security (DHS) issued proposed regulations to implement the Act in March 2007; final regulations were issued in January 2008. In November 2008, the Maryland Motor Vehicle Administration (MVA) submitted a response to the 2008 *Joint Chairmen's Report* (JCR), which restricted certain MVA expenditures until MVA submitted a report to the budget committees on any efforts to implement the REAL-ID Act. Among other

things, MVA's response provided new estimates of compliance costs as well as an overview of possible State legislation that may be needed for compliance, as described in more detail below.

Fiscal Concerns

Immediately after enactment, many states expressed concerns about the Act both individually and through the National Conference of State Legislatures (NCSL), the National Governors Association (NGA), and the American Association of Motor Vehicle Administrators (AAMVA). A significant majority of the states perceived the Act as costly, intruding on privacy, and infringing on states' authority. The fiscal impact to the states appeared to be the most significant concern, however.

Estimated Costs to the States

A national survey of the states conducted by NCSL, NGA, and AAMVA immediately after enactment of the Act estimated the costs to the states over the first five years at approximately \$11.0 billion (\$1.0 billion in upfront costs and approximately \$10.0 billion in ongoing costs). In its economic impact analysis relating to the proposed federal regulations, DHS estimated the total cost to states to be \$14.6 billion; however, according to DHS, the final federal regulations are estimated to cost the states \$9.9 billion.

Maryland's Estimated Costs

Shortly after enactment, and as part of the national survey described above, MVA estimated the State's compliance costs at \$150 million. After reviewing the federal regulations proposed in 2007, MVA refined its estimate to \$80 to \$100 million over five years for a one-tiered system or \$60 to \$80 million for a two-tiered system under which MVA could issue noncompliant ID cards to applicants who request them, as well as compliant ID cards, under a two-tiered system. In its November 2008 response to the JCR, MVA further refined its cost estimate; assuming the implementation of a one-tiered system, costs are now estimated at \$30 to \$37 million in operating costs over five years and \$9 million in capital costs over six years.

Under current law, MVA is required to recover between 95 and 100 percent of annual operating and capital expenditures through the miscellaneous fees that it assesses. As a result, MVA's implementation costs will need to be funded through ID cards or other MVA fees. In order to offset its anticipated costs, MVA expects that it will need to increase ID card fees by up to \$15.

Deadlines

DHS may grant extensions to a state to meet the requirements of the Act. The final regulations maintain an implementation date of May 11, 2008, but allow DHS to grant an initial extension “to meet the requirements of [the Act],” if a state provided notice by March 31, 2008. An initial extension is valid until December 31, 2009. All states, including Maryland, have been granted this extension. The final regulations allow a state to request, by October 11, 2009, an additional extension to May 10, 2011. An additional extension may be granted only if a state certifies material compliance with the 18 benchmarks contained in DHS’s “Material Compliance Checklist” that was issued as an attachment to the final regulations. The summary of the final regulations states that “[t]he eighteen milestones are all mandatory requirements under the Act; one of the most important ones, however, is the state’s ability to verify that the applicant is lawfully present in the United States.” If a second extension is granted, a state must begin issuing REAL-ID compliant ID cards on May 11, 2011.

The schedule under the final regulations for renewal of compliant ID cards is bifurcated based on the age of the applicant. Anyone born on or after December 1, 1964, has until December 1, 2014, to obtain a compliant ID card. Anyone born before December 1, 1964, has until December 1, 2017, to obtain a compliant ID card.

2009 Session Implications

To comply with the Act, the State must adopt federal standards and modify any conflicting statutes or regulations to continue to have its ID cards recognized by a federal agency for an official purpose. The Governor and the Secretary of the Department of Transportation have stated their intent to comply with the Act. Thus, it is anticipated that legislation to harmonize State law with the Act may be introduced during the upcoming legislative session. This legislation may include (1) a requirement that an applicant for an ID card show lawful presence; (2) a requirement that MVA issue a temporary ID card to certain lawfully present applicants; (3) extension of the term of licensure from five to eight years, as is allowed under the Act, to help spread out implementation costs; (4) the requirement of background checks of MVA employees in sensitive positions; and (5) the requirement of an applicant for a personal ID card to provide a Social Security number or certify that the applicant is not eligible for a Social Security number (currently only required for driver’s license applicants). Finally, the issue of whether to implement a one-tiered or two-tiered system also is expected to be considered by the General Assembly.

Business Regulation

Retail Electric Restructuring and Electricity Rates

Retail electric competition has not developed significantly in the residential sector, although it has done so for commercial and industrial customers. Although residential electric rates continue to increase in the short term, proposed new generation and transmission facilities and energy efficiency programs may assist in lowering or stabilizing prices in the long run. Public Service Commission reports will evaluate whether the State should reregulate or substantially modify the procurement of electricity for residential retail customers. With high energy costs, the need for additional low-income assistance continues to grow.

Rates, Alternative Suppliers, and Competition

The Electric Customer Choice and Competition Act of 1999 restructured the electric utility industry in Maryland, introducing “customer choice” of supply services and setting a mandated rate reduction and a cap on the reduced rates. Once price caps on Allegheny Power’s residential standard offer service (“SOS”) expire on January 1, 2009, rate cap restrictions will have expired for all residential, commercial, and industrial customers in the State. With the expiration of price caps, customers are subject to market rates. For most residential customers, those who have not chosen competitive supply, the price of supply depends on the results of SOS wholesale electric supply auctions which use a bid request process for the load obligations of each utility. Bid offers with the lowest price are selected. Due to continued significant increases in the prices of commodities used to generate electricity, SOS rates continue at a high level.

Exhibit 1 shows the percentage increases for the average annual total bill of a residential consumer from the auctions to procure power during the period from July 1, 2004, to May 31, 2009, for the three investor-owned utilities whose rate caps expired during that period. Most Allegheny Power residential customers are moving to market rates through a series of transitional rates designed to limit increases to approximately 15 percent per year through 2010.

During the initial transition period from 2000 through 2004, which aimed to give the electric industry time to switch to a competitive market, electricity suppliers were unable to compete with the below-market rates in effect under the rate caps. Although electric restructuring has primarily benefited big electricity users, such as industrial customers and State and local government operations, electricity suppliers only slowly started to enter the market for residential customers as the price caps expired in each service territory. As of October 2008, approximately 3 percent of residential customers were being served by a competitive supplier, as compared with 16 percent of small commercial, 45 percent of mid-commercial, and 88 percent of large commercial/industrial customers being competitively served. About 26 companies are licensed by the Public Service Commission (PSC) as electricity suppliers for the residential

sector in the State, and many of these are licensed in more than one service territory. However, only about 9 suppliers indicate that they are actively seeking new residential customers.

Exhibit 1
Percentage of Rate Increase for the Average Annual Total Bill⁽¹⁾
SOS Auctions for Residential Load
July 1, 2004 – May 31, 2009

	<u>Date Rate Caps Ended</u>	<u>2004 Auctions: July 1, 2004- May 31, 2005</u>	<u>2005 Auctions: June 1, 2005- May 31, 2006</u>	<u>2006 Auctions: June 1, 2006 for Pepco/Delmarva; July 1, 2006 for BGE – May 31, 2007</u>
Pepco	June 30, 2004	16%	4.5%	39%
Delmarva	June 30, 2004	12%	5.8%	35%
BGE	June 30, 2006	Not applicable	Not applicable	72% ⁽²⁾

	<u>2007 Auctions: June 1, 2007- May 31, 2008</u>	<u>2007/08 Auctions: June 1, 2008- May 31, 2009</u>	<u>Average Estimated Annual Bill: June 1, 2007 – May 31, 2008</u>
Pepco	6.9%	5.5% ⁽³⁾	\$1,826 (at average consumption of 950 kWh/month)
Delmarva	5.1%	2.7% ⁽³⁾	\$1,944 (at average consumption of 1,100 kWh/month)
BGE	50.4%	7.6% ⁽⁴⁾	\$1,947 (at average consumption of 1,000 kWh/month)
Allegheny	Not applicable	15.7% ⁽⁵⁾	\$1,466 (at average consumption of 1,300 kWh/month)

Notes:

⁽¹⁾ Average annual total bill includes distribution, transmission, and SOS costs.

⁽²⁾ Under Chapter 5 of the 2006 special session, the actual increase billed to customers was limited to 15 percent for 11 months; the remainder was deferred under Rate Stabilization Plan I.

⁽³⁾ The impact of recent distribution rate increases is included in the percentage increase.

⁽⁴⁾ The impact of charges for recovery of deferred Senate Bill 1 revenue and credits for nuclear decommissioning and reinstatement of the SOS margin in June 2008 are included in the percent increase.

⁽⁵⁾ Effective January 1, 2009 through May 31, 2010; includes an estimated rate for the Rate Transition Surcharge associated with the phased-in 15 percent year-over-year rate increase.

SOS: Standard Offer Service.

Source: Public Service Commission

Although a truly competitive residential market has not developed, as of October 2008, five suppliers are offering a total of 16 alternative plans to SOS for BGE residential customers;

two suppliers are offering 7 alternative plans to Delmarva customers; and four suppliers are offering 13 alternative plans to Pepco customers. Most of these plans have a “green” energy component which generally causes the cost to be higher than SOS. The price to compare for BGE’s SOS is \$0.1180/kWh, Delmarva’s SOS is \$0.1133/kWh, and Pepco’s SOS is \$0.1175/kWh. As a result of the entry of competitive suppliers, almost 28,800 BGE residential customers (2.6 percent of total customers), over 28,000 Pepco residential customers (5.9 percent of total customers), and over 1,300 Delmarva residential customers (0.8 percent) had switched from SOS by the end of October 2008.

Reports Anticipated from the Public Service Commission

Chapter 549 of 2007 (Senate Bill 400) required PSC to initiate new proceedings to expand on several studies required under Chapter 5 of the 2006 special session (Senate Bill 1). The 2006 enactment required PSC to conduct specific studies of the process that had taken place in electric restructuring and to prepare recommendations for going forward in a manner to protect ratepayers from excess price volatility, reporting to the General Assembly at the end of 2007 and 2008, in addition to strengthening the review process for certain utility mergers and acquisitions and making several other significant changes. The 2007 Act also required PSC to conduct additional studies and complete reports on electric industry reregulation, assess the availability of adequate transmission and generation facilities to serve the electrical load demands of all customers in the State, and consider the implications of establishing an office of retail market development and establishing a long-term goal for energy efficiency and conservation, among many other matters.

On December 1, 2007, PSC issued a preliminary report identifying the issues relating to options for reregulation, including discussion of costs and benefits of returning to a regulated electric supply market. Through examination of testimony from contested case proceedings and quasi-legislative proceedings and legal and economic consulting services of Kay Scholer LLP and Levitan Associates, Inc., PSC found that (1) Maryland faces a serious reliability concern in the 2011-2012 timeframe; and (2) market conditions have caused high prices. The reliability concern arises from the lack of new generation in the State, coupled with inadequate transmission capabilities and growing demand, which taken together may cause brownouts in the summers of 2011 and 2012. The chronic high price of electricity stems from Maryland’s status as a net importer of energy that is served by transmission lines with capacity inadequate for peak summer demand. This transmission congestion in central and eastern Maryland has spurred the Federal Energy Regulatory Commission (FERC) and PJM Interconnection, LLC (PJM), the organization responsible for the transmission grid covering 13 states and Washington, DC, to impose charges and adopt wholesale market rules intended to promote development of new transmission and generation capacity serving these areas.

PSC outlined various options for “reregulation” considering tradeoffs among direct costs, risks, and benefits. The most costly option appears to be recapture of the previously regulated generation fleet through requiring Maryland utilities to repurchase their generating fleet, or through eminent domain and a corresponding payment of the fair market value of the fleet,

estimated to be \$18-24 billion. Other options involve measures to mitigate price volatility for residential consumers that include directing utilities to enter into long-term contracts for new generation, establishing a State power authority to initiate power projects, adopting integrated resource planning to coordinate a variety of efforts, and aggressively intervening in FERC proceedings to shape PJM wholesale market policies. A final report containing the complete set of evaluations, findings, and recommendations for all studies as required by the Act is due December 1, 2008.

Reregulation Activities in Other States

Due to the generally unsatisfactory results of restructuring for residential customers, several states that previously undertook the restructuring of their electric utility industries have, at least to some degree, reversed or substantially altered their restructuring policies to return to a regulated regime for retail sales of electricity to at least a portion of the retail customer base. General application of these changes to Maryland is difficult, however, as the details of each plan are idiosyncratic to its state's version of electric restructuring.

- In Connecticut, 2005 legislation allowed utilities that were previously prohibited from building or owning power plants to build peaking capacity beginning in 2008 with cost-based recovery of expenses. Merchant generators may also bid on peaking projects and charge cost-of-service rates if chosen. The state commission may order proposals for new plants and approve purchases of plants if it determines there is insufficient capacity.
- In Delaware, 2006 legislation allowed distribution companies to enter into long- and short-term supply contracts and own and operate generation facilities; and requires these utilities once again to perform integrated resource planning.
- In Illinois, to protect against future rate spikes, the 2007 legislature considered creating a state power authority, established with general funds, to buy or generate power for use by the state's citizens and businesses. The authority would take the place of the power auctions previously conducted by the utilities to provide default electricity service. Although the authority was established, it has not yet supplanted the competitive supply auction system in the state.
- In Virginia, 2007 legislation reestablished rate-of-return regulation starting January 1, 2009, and provided incentives for utilities to build new base-load generation. The utilities' authorized rate of return is pegged to the returns of other utilities in the southeast, with the potential for enhanced returns. Because utilities were not permitted to divest themselves of generation resources when Virginia enacted its industry restructuring, the continued ownership of generation allows an easier return to regulation than would be the case in Maryland, where the utilities were required to sell their generation assets or transfer those assets to an unregulated affiliate.

- In Montana, 2003 legislation extended the deregulation transition period to 2027. Open access for customers other than those with large demand has been reversed, and power supply is to be provided by distribution companies under long-term contracts. The distribution companies divested themselves of generation with the implementation of restructuring and are currently seeking authorization to construct new generation resources.
- In Michigan, 2008 legislation capped electric choice at 10 percent, giving the state's two dominant utilities an almost-guaranteed income as an incentive to build new power plants using cost-based rates.

Adequacy of Generation and Energy Efficiency Measures

As a net importer of electricity, Maryland must address any shortfall in its electricity supply in one or more of three areas. It may (1) encourage the building of new in-state generating capacity; (2) encourage the construction of new transmission capacity to import cheaper electricity from areas such as the Ohio River Valley; or (3) decrease demand for electricity and moderate peak demand by implementing energy efficiency and demand reduction strategies. The first two options are the utility industry's traditional approach to capacity constraints; the third is now being promoted as State policy through 2008 legislation.

Maryland purchases more than a quarter of its electricity from other states – and the figure may exceed 40 percent on hot summer days. Obtaining power from other states, such as Pennsylvania and West Virginia, is costly for Maryland ratepayers because of transmission congestion. Maryland's increasing dependence on energy from outside the State will cause further congestion in the transmission system. PJM has projected transmission overloads for 2012, warning that Maryland should construct three new 600-megawatt power plants in the next decade to maintain its energy status quo and avoid electricity shortages and possible blackouts or brownouts on hot summer days as soon as 2011.

FERC has addressed the transmission shortfall by imposing mandatory charges in congested areas, including central Maryland, in order to spur construction of new transmission facilities that will serve these areas. In addition, PJM has developed a system to provide incentives for construction of new generation and transmission facilities in its recently implemented reliability pricing mechanism (RPM). RPM is a market system in which electricity suppliers bid to provide capacity in future years and has been the subject of controversy. In October 2008, PSC and a broad coalition of electricity buyers in the PJM region requested FERC to rehear a complaint against RPM. The complaint contends that transitional RPM auctions will cost Marylanders approximately \$2 billion in overpayments but have resulted in no new capacity in the constrained region of PJM.

Furthermore, PSC requested that PJM convene a Regional Reliability Summit in November 2008 to provide each state with a status of the regional reliability situation, and a

state-by-state analysis of potential electricity shortfalls. Other activities which may assist with reliability and the lowering or stabilizing of prices are described below. Transmission upgrades are expected to lower congestion costs considerably when completed, but have little impact on the commodity-driven costs of generation.

In the area of planning, PSC ordered the State's investor-owned utilities to file detailed comments in September 2008 regarding possible electricity shortages and potential solutions to alleviate potential short-term reliability problems in the State. PSC is considering whether to direct the utilities to issue "Gap RFPs" to acquire new electric capacity to cover any shortfalls.

In the area of new generation, Competitive Power Ventures, Inc., a merchant generator, was granted a certificate of public convenience and necessity (CPCN) in October 2008 to build a new 640-megawatt combined-cycle natural gas-fired electric power generating station in Charles County, estimated to power about 600,000 homes. Construction is anticipated to begin in mid-2009 and be completed in early 2012.

Three new transmission projects are planned. The Potomac-Appalachian Transmission Highline and the Trans-Allegheny Interstate Line Company are proposing transmission lines to ease the transmission of electricity from coal-fired plants in the Ohio River Valley into central Maryland and Northern Virginia. Another project, the Mid-Atlantic Power Pathway, is planned to travel from Northern Virginia to Maryland, cross the Delmarva Peninsula, and link to the power grid in southern New Jersey. The proponents anticipate completion dates as soon as 2012.

Maryland is actively pursuing energy efficiency and demand reduction goals under the EmPOWER Maryland legislation, Chapter 131 of 2008 (House Bill 374). The Act requires electric companies to procure and provide customers with a cost-effective demand response program that is designed to achieve 15 percent electricity savings and peak demand reductions through 2015. To the extent it determines that cost effective energy efficiency and conservation programs are available for each affected class, PSC must require electric companies to procure and provide customers with a cost-effective demand response program designed to achieve 10 percent targeted electricity savings and demand reduction. The remaining 5 percent reduction in electricity consumption by 2015 should be achieved through State-sponsored efforts led by the Maryland Energy Administration (MEA).

As of November 2008, PSC has approved several low-income and demand-side programs and is reviewing additional conservation and energy efficiency programs which may further lower demand so that the State may reach the required consumption and peak demand reduction targets. Under Chapters 127 and 128 of 2008 (Senate Bill 268/House Bill 368), MEA may use a portion of the proceeds of carbon allowances auctioned under the Regional Greenhouse Gas Initiative (RGGI) to support energy efficiency, conservation, and demand reduction efforts. Following the first quarterly auction held in September 2008, 46 percent of the total \$16.4 million funds would be used for energy efficiency, conservation, and demand response programs. The Strategic Energy Investment Advisory Board is in the process of reviewing the proposed fiscal 2009 budget and programs developed by MEA.

Business Regulation

Acquisition of Constellation Energy Holding Company

<p>As a result of the financial instability of the credit markets, a downturn in economic conditions, and its own involvement in volatile commodities-based businesses, Constellation Energy Holding Company recently decided to sell itself to MidAmerican Energy Holding Company. The Public Service Commission will determine whether the acquisition is in the public interest.</p>
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Financial Instability for Constellation Energy Group

Constellation Energy Group (Constellation), a Baltimore-based energy trader and provider holding company, employs about 10,200 workers worldwide, including about 6,700 based in Maryland. The holding company owns Baltimore Gas and Electric Company (BGE), a regulated utility delivering power and natural gas to more than 1.2 million electric and 640,000 natural gas residential, commercial, and industrial customers in Baltimore City and in all or part of 10 counties in central Maryland. In addition, the holding company owns a commodity business that involves wholesale marketing and risk and portfolio management and trading operations; a retail electricity supply business that provides energy products and services to commercial, industrial, and public-sector organizations throughout North America; a natural gas supply and transportation-related services operation; a power generation operation that includes fossil and renewable energy generating facilities; a nuclear energy generation and development operation; a full-service energy company providing customized energy and environmental solutions; and a competitive provider of energy-related products and services.

Constellation's commodity business, a volatile market-based enterprise, has relied heavily on the credit markets for its liquidity needs. With extraordinary volatile market conditions, including increased costs for natural gas, crude oil, and coal, in early September 2008 Constellation was forced to significantly increase its collateral postings and improve its balance sheet. However, Constellation had business ties with Lehman Brothers, including a line of credit from that investment bank. With the collapse of Lehman Brothers, analysts raised concerns about Constellation's participation in volatile trades. With the growing instability in credit markets, it was not clear whether Constellation's \$2.0 billion line of credit from a consortium of financial institutions would still be available and unimpaired. At the same time, national credit rating agencies revealed that they were considering a downgrade of Constellation's credit rating, making it significantly more expensive for the company to borrow funds needed for its merchant business contracts. Earlier in 2008, Constellation had misstated in its financial reports the extent of its exposure should the credit ratings it needed to borrow money for its merchant business contracts ever be downgraded to junk status. Such a downgrade would have compelled the company to post \$1.6 billion more than had previously been disclosed.

Between September 15 and 17, 2008, Constellation's shares fell from about \$58 per share to \$24.77, as consumer confidence dwindled and investors sold their common stock at an unprecedented trading volume (for a brief time, the stock price dropped to \$13). On September 17, one rating agency put Constellation and BGE on its credit watch, indicating that a multiple-notch downgrade was likely without the sale of Constellation. On the same day, after examining its strategic options and potential partners, Constellation accepted an offer to sell itself to the MidAmerican Energy Holding Company (MidAmerican) in a cash transaction. MidAmerican initiated a letter of agreement in principle of its intent to acquire all the outstanding shares of Constellation. On September 18, Constellation and BGE filed a Form 8-K with the Securities and Exchange Commission (SEC) to begin the formal acquisition process. On September 19, the boards of directors of both Constellation and MidAmerican approved a definitive agreement that the companies filed with the SEC in New York.

Although other higher bids might have been on the table, such as one by Électricité de France (EDF), one of Constellation's largest shareholders at 9.5 percent and partner in nuclear power development in Maryland, Constellation indicated that the MidAmerican agreement would allow easier regulatory approvals and provide an immediate stabilizing effect, given the prevailing volatile market conditions. EDF filed a letter with SEC on September 23, indicating that the deal with MidAmerican "does not provide adequate value to shareholders." Seven lawsuits have been filed, one in U.S. District Court for the Southern District of New York and six in Baltimore City Circuit Court, claiming that the agreement was too low and that additional time should have been given to consider other offers. Several lawsuits allege that the Constellation board of directors failed to live up to its fiduciary responsibilities, noting that the \$26.50 offer is almost 60 percent lower than what the company was worth a week before the agreement announcement on September 18 and only 7 percent above the September 17 closing price of Constellation shares.

The Acquisition Agreement

MidAmerican, an Iowa-based corporation with approximately 17,200 employees, is a global leader in the production, transportation, and delivery of energy from a variety of fuel sources, including geothermal, natural gas, hydroelectric, nuclear, coal, wind, and biomass. With approximately 6.9 million electricity and gas customers, MidAmerican is also a leader in the distribution of energy in consumer markets. Its subsidiaries include various regulated electric and gas utilities serving customers in California, Idaho, Illinois, Iowa, Nebraska, Oregon, South Dakota, Utah, Washington, and Wyoming; geothermal power plants in California; natural gas fueled generating stations in Arizona, Illinois, New York, and Texas; electricity distribution businesses that serve approximately 3.8 million customers in the northeast United Kingdom; two natural gas pipelines serving the Midwest and Southwest; and a residential real estate brokerage company.

MidAmerican is a subsidiary of Berkshire Hathaway, Inc., a conglomerate holding company headquartered in Omaha, Nebraska and headed by Warren E. Buffett as chairman and CEO. The conglomerate has investments in a diverse range of businesses, including candy

production; retail, home furnishings, encyclopedias, vacuum cleaners, and jewelry sales; newspaper publishing; manufacture and distribution of uniforms; manufacture, import, and distribution of footwear; and regional electric and gas utilities. The conglomerate owns Dairy Queen, Fruit of the Loom, and Geico. Berkshire acquired MidAmerican in March 2000.

Maryland law governs the acquisition of Constellation by MidAmerican. For a 14-day period, MidAmerican had full access to Constellation's books and records, during which Constellation was prohibited from seeking other buyers. Proxy statements and other reports further defining the agreement filed with SEC specify that:

- MidAmerican will purchase all of the outstanding shares of Constellation for approximately \$4.73 billion in cash, or \$26.50 per share of common stock.
- MidAmerican will provide an immediate \$1.0 billion cash infusion to Constellation through the purchase of Series A 8 percent Preferred Stock at a purchase price of \$100,000 per share from Constellation. The funds were received on September 22, 2008.
- To fund the \$4.73 billion purchase of common stock, MidAmerican will issue an additional \$2.0 billion of 11 percent Trust Preferred securities and \$2.73 billion of common stock to Berkshire.
- Constellation will owe \$175 million to MidAmerican should the agreement be terminated for any reason.
- A condition for consummation of the sale includes that there will not be any material adverse effect after the date the agreement was finalized. A change in the net economic value of businesses or assets exceeding \$200 million is deemed to be material.

Post-employment compensation for executives depends on how the termination is classified. Constellation's top executives have "change of control agreements" guaranteeing that if they are terminated within two years after a change of control "without cause or resignation with good reason" they are entitled to a lump sum based on salary/bonuses, as well as other payments. Mayo A. Shattuck III, Chairman and CEO, is entitled to \$18.0 million cash severance; \$29.6 million enhanced pension; and \$48,000 health benefits. However, in an SEC filing dated October 16, Mr. Shattuck waived any right to receive the \$18.0 million severance, requesting that Constellation apply that amount to charitable donations. He also waived his right to accelerated vesting of his net accrued benefit under Constellation's supplemental benefit plans that would exist only if the acquisition is completed.

Approval Requirements

In a series of processes that are anticipated to take nine months, the acquisition of Constellation by MidAmerican must be reviewed by the Constellation shareholders, the Maryland Public Service Commission (PSC); the Federal Energy Regulatory Commission, and the Nuclear Regulatory Commission. The companies have made all required initial filings with PSC and the relevant federal agencies, including the filing of proxy statements and other reports with SEC. As of early November 2008, a date for a shareholder vote has not yet been set.

On October 17, Constellation, MidAmerican, and BGE filed an application with PSC for approval of the acquisition of Constellation by MidAmerican. Opening the acquisition proceeding as Case Number 9160, PSC held a prehearing conference on November 3, at which PSC ruled on the procedural schedule and other preliminary matters.

Acquisitions and mergers of gas and electric companies, and their holding companies, are governed by § 6-105 of the Public Utility Companies Article. No transaction can be completed involving any acquisition, directly or indirectly, of the power to exercise substantial influence over the policies and actions of a gas and electric company without PSC approval. The statute requires PSC to examine and investigate any proposed transaction and undertake “necessary or convenient” proceedings before issuing an order. At the close of its proceedings, PSC is required to (1) grant the application if PSC finds that the acquisition is “consistent with the public interest, convenience and necessity, including benefits and no harm to consumers”; (2) condition approval on “the applicant’s satisfactory performance or adherence to specific requirements”; or (3) deny the application outright. The applicant bears the burden of showing that granting the application, and thus approving the acquisition, satisfies all aspects of the standard, including the benefits and lack of harm to consumers.

By statute, PSC must render a decision within 180 days after receiving the application, although the agency may extend the review period by 45 days for good cause. Constellation and MidAmerican requested that PSC issue an order not later than April 15, 2009, approving the acquisition. According to PSC, it has allocated internal resources to ensure a complete and thorough evaluation of the proposed transaction and the underlying circumstances within the required timeframe. PSC intends to raise relevant issues not raised by the parties under its inherent authority. The agency also maintains that its decision on the acquisition will be made on a fully analyzed record and will be publicly addressed through testimony and evidence before it, including evidentiary hearings and evening hearings for public input. In early October, PSC issued two requests for proposals for expert advisors to assist PSC and its staff in evaluating the proposed acquisition. The agency has also submitted a budget amendment totaling \$2.5 million for funding of consultant expenses. As required by law, PSC will consider the following broad range of issues:

- the potential impact on rates and on services and conditions of the public service company – in this case, BGE;

- the potential impact on continuing investment needs for utility services and infrastructure;
- the proposed capital structure, including the allocation of earnings from the public service company;
- the potential effects on employment by the public service company;
- the projected allocation of any savings expected between stockholders and rate payers;
- reliability, the quality of service, and the quality of customer service;
- any impact on community investment;
- any affiliate and cross-subsidization issues, including use or pledge of utility assets to benefit an affiliate – in this case, any portion of Constellation, MidAmerican, or Berkshire Hathaway;
- jurisdictional and choice of law issues;
- whether it is necessary to revise PSC's ring fencing regulations, which protect the integrity and quality of utility services provided by a state-regulated public service company when the company is sold to an entity not otherwise subject to that state's jurisdiction, and code of conduct regulations; and
- any other issues PSC considers relevant.

Agreement Commitments

Constellation and MidAmerican made several specific commitments in their PSC filings and the testimony of key officials as follows:

- *BGE Customer Rate Benefits:* The parties pledge to provide to BGE customers benefits valued at an estimated \$70 million from (1) cutting, to 2.5 percent, the 5 percent cap that was to apply to any increase in an electric distribution rate case filed by BGE in 2009 under the March 2008 settlement agreement between BGE, PSC, and the State of Maryland; (2) committing not to file a second BGE electric distribution rate increase until January 2011; and (3) committing not to seek a second gas distribution rate increase until

January 2011. Also, no costs related to the acquisition transaction or to any severance or change in control payments by Constellation will be collected from the BGE rate base.

- *UniStar Nuclear Energy:* MidAmerican reaffirms support for the UniStar Nuclear joint venture and proposed nuclear plan development at Calvert Cliffs.
- *Charitable and Community-related Contributions:* BGE's contributions will be maintained at no less than the past three-year average level of approximately \$2.887 million each year through December 31, 2013. Furthermore, Constellation will continue to be a prominent contributor and MidAmerican will match the amount of cash severance waived by Mr. Shattuck, resulting in a total endowment increase of \$36.0 million to support future charitable endeavors in Baltimore City and the State. The foundation has given money to nonprofits such as Kennedy Krieger Institute, the B&O Railroad Museum, the Maryland Food Bank, and the United Way.
- *BGE Will Operate as It Does Today:* BGE will not be merged with other utility operations under MidAmerican. BGE will develop and implement its own business plans and budgets and have its own board of directors.
- *Constellation and BGE Headquarters:* Both Constellation Energy and BGE's headquarters will remain in Baltimore and no reduction in force at BGE is planned. No reduction of force would occur before 2012, if ever.
- *Ring Fencing:* BGE will be protected from any adverse financial conditions at Constellation or MidAmerican or any of their affiliates through a ring fencing procedure.
- *Regulated Generation Facility:* MidAmerican has committed to study the feasibility of BGE owning and operating a regulated generation facility in Maryland. The evaluation and recommendation will be brought before PSC for review within 12 months after close of the acquisition transaction.
- *Low-income Needs:* MidAmerican and BGE will initiate a collaborative effort to discuss potential approaches for the PSC's consideration for serving the "essential needs" of low-income electric and gas distribution service customers.

Business Regulation

Workers' Compensation

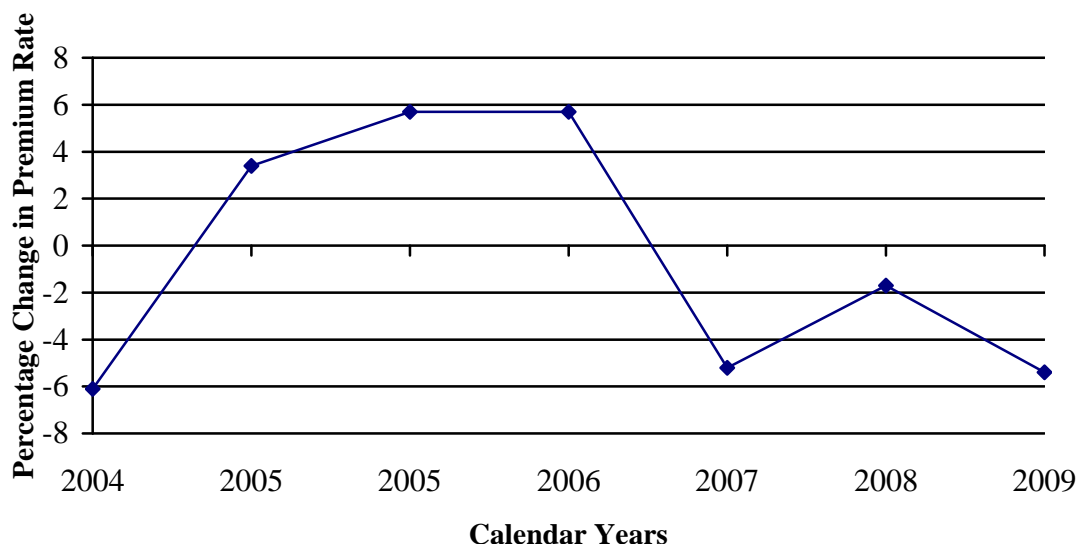
The two most significant legislative issues governing workers' compensation in the 2009 session may be related to regulation of the Injured Workers' Insurance Fund (IWIF) and misclassification of employees as independent contractors. Legislators may also see proposals to increase benefits for dependents and to limit benefits for incarcerated individuals who received a workers' compensation award. Overall, the workers' compensation system in Maryland continues on a stable course, with another annual decrease in premiums and continued decline in claim frequency; however, some cost drivers and benefit concerns remain.

Stable Short-term Costs but Benefits Are Below Average

The Workers' Compensation Research Institute released a benchmark study in January 2008 that compared Maryland to 13 other states for claims filed between 2000 and 2005; Maryland fared well as overall costs per claim were comparable to the other states and the growth in costs for claims of more than seven days has slowed. According to an annual review of "office and clerical" and manufacturing industries workers' compensation costs by Actuarial & Technical Solutions, Inc., Maryland is the tenth lowest in workers' compensation comparative costs in 2008 for manufacturing and seventh lowest for office and clerical. One of the main factors in limiting costs is a continued decline in claim frequency, which follows a national trend. The current economic downturn may also exert downward pressure on wages, further limiting costs.

This continued stability has resulted in a decrease in employers' premiums. **Exhibit 1** shows the recent history of loss cost filing in Maryland. Loss cost filing reflects the average workers' compensation costs incurred in one year by various industries. Insurance carriers use it as a base for calculating rates, adding their own loss adjustment and overhead expenses. The new rate filing for the voluntary market, filed by the National Council on Compensation Insurance (NCCI) for 2009 will mean lower premiums for most employers; the overall average decrease in the loss cost rate is approximately 5.4 percent, though loss cost rates will vary by industry. (Also, actual premium rates paid by employers will vary by insurer as insurers add their own cost expense and profit factor to the loss cost rate that NCCI develops.) The loss cost rate filing drop is larger than last year, which only saw a 1.7 percent decline, and is almost identical to the 5.2 percent decrease for 2007. The rate filing assumes a 0.7 percent increase in indemnity benefits. As mentioned below, NCCI's loss cost rate filing does not reflect IWIF's claim experience; however, IWIF's base rates (which includes a cost expense and profit factor) have followed a similar trend with no change in rates in 2007 and rate decreases in the last two years (5.0 percent in 2008 and 6.8 percent in 2009).

Exhibit 1
Rate Filing Activity
2004-2009



Source: NCCI State Advisory Forum, 2008

However, two trends may warrant monitoring or discussion. Maryland slipped in its national ranking for average total benefit (medical and indemnity) per employee from twentieth to twenty-second and ranks the lowest in the region for average statutory indemnity benefits, according to NCCI. Additionally, the number of workers 45 to 64 years of age will peak in 2010. The injuries incurred by workers in this age group tend to be more severe and sometimes more difficult to treat, with longer recovery periods and corresponding higher costs.

Oversight of IWIF

During the 2008 legislative session, considerable discussion arose about the role and oversight of IWIF. The quasi-State entity began as the State Accident Fund in 1914 and has evolved into a sizable insurance carrier in the private sector, accounting for 28 percent of the State's workers' compensation underwriting market. Lawmakers introduced several bills to address concerns related to rate filing, rate making, marketing activity, and auditing authority. Currently, IWIF is not required to file its claim experience with NCCI, and IWIF is not required to use NCCI's loss cost rate filing when determining its actual base rates. Furthermore, the Maryland Insurance Administration (MIA) has no oversight of IWIF's rate making process, as it does over other carriers. IWIF's base rates are approved by IWIF's board of directors.

Under Chapter 612 of 2008, MIA is required to study several issues related to IWIF and submit a report to the General Assembly by December 1, 2008, that evaluates the following:

- whether IWIF's rate making process produces actuarially sound rates;
- the financial impact to IWIF if it were to join NCCI;
- comparison of IWIF's experience rating plan for small businesses to the plan used by NCCI; and
- identification of laws related to consumer protections and financial soundness that apply to other insurers but not to IWIF.

Chapter 612 also enables the Insurance Commissioner to issue corrective orders to IWIF. Previously, MIA could examine IWIF as it does other insurers but had limited enforcement authority. Depending on the recommendations of the report, additional legislation that further regulates IWIF may be introduced.

Misclassification of Employees – Interim Workgroup

One of the most controversial issues affecting the workers' compensation community, as well as the business community at large, is the appropriate classification of workers. Legislation sponsored by the Department of Labor, Licensing, and Regulation (DLLR) in 2008, House Bill 1590, would have created a presumption of employment and put the burden of proof on the employer to prove that a worker is in fact an independent contractor. The bill also proposed several types of penalties on employers who misclassify employees and enabled the employee to sue the employer. Although the legislation failed, DLLR convened a workgroup consisting of contractors, union leaders, and advocacy groups to discuss the failed bill and the challenges in addressing the misclassification issue.

Data regarding the number of workers misclassified, and thus ineligible for workers' compensation and unemployment benefits, is not currently available. The Workers' Compensation Commission (WCC) typically does not know that a worker has been misclassified until a claim is filed. If the claim is valid, the payment will come from the Uninsured Employers Fund, as the employer did not purchase the required insurance. While WCC may order the employer to buy coverage and assess a fine, its statutory authority to proactively investigate classification is unclear.

Legislation on Benefits

Prisoners

Within 21 days of the mailing of the notice of the filing of a claim, the employer or its insurer must begin paying temporary total disability benefits or file an issue with WCC to contest the claim. Concern has been raised with payment of these benefits for an employee who has been incarcerated after the injury, specifically the employer's or insurer's difficulty with obtaining an independent medical evaluation to determine the claimant's current medical and disability status; or inability to provide continued employment with restrictions to accommodate the injury, which would allow the employer to cease disability payment. Legislation may be introduced in the 2009 session to provide for payment cessation while the employee is incarcerated.

Death Benefits

Under current law, if an employee dies while receiving permanent total or permanent partial benefits or the employee dies as the result of a compensable injury, the employee's dependents are entitled to a weekly benefit. The benefits vary, depending upon whether the dependents are partial or total dependents. The law does not explicitly define total and partial dependents and authorizes WCC to determine dependency on a case-by-case basis. Partial dependents are only eligible for payments if there are no individuals who were wholly dependent on the deceased employee.

Total dependents (surviving spouse or child) are currently entitled to a benefit equal to two-thirds of the deceased employee's average weekly wage, not to exceed the State average weekly wage. The weekly benefit must be paid for the period of dependency or until \$45,000 has been paid; however, if a spouse or child remains wholly dependent after the \$45,000 cap is reached, he or she is entitled to continued payments. A wholly dependent spouse receives no further payment if he or she remarries and has dependent children at the time of the remarriage. If the spouse has no dependent children, payments must continue for two years after the date of remarriage.

If the surviving spouse or child becomes wholly self supporting, the employer or insurer must continue payments until the \$45,000 cap is reached. If the spouse becomes partly self supporting, the payments must also continue, but the cap is \$60,000, which includes any payments made while the spouse was wholly dependent. This cap was last changed under Chapter 319 of 2003, which also altered the maximum weekly benefit for partial dependents so that it is recalculated as if the spouse had been partly self supporting at the time of the covered spouse's death. If a partly dependent spouse with no dependent children remarries, payments are required for two years after the date of remarriage if the \$60,000 cap was not reached before the remarriage.

Business Regulation

Unemployment Insurance Trust Fund and Oversight Committee

Due to the economic downturn, it is anticipated that calendar 2008 will be the highest benefit payout in recent years. Consequently, the balance in the unemployment insurance trust fund has decreased to a level that requires employers to pay from a higher tax table for calendar 2009. The Committee on Unemployment Insurance Oversight monitors the status of the trust fund and makes recommendations on the unemployment insurance system.

Background

Legislation enacted in Maryland in 2005 (Chapter 169) altered the unemployment insurance (UI) charging and taxation system by creating a series of experience tax rate tables that are based on the balance in the UI trust fund. The Committee on Unemployment Insurance Oversight was created to monitor these changes. To provide the legislature with additional oversight of the trust fund's financial position, the General Assembly adopted narrative within the 2008 *Joint Chairmen's Report* requiring the Division of Unemployment Insurance in the Department of Labor, Licensing, and Regulation (DLLR) to report on aggregate inflows, outflows, and balances of the trust fund on a quarterly basis.

Unemployment Insurance Trust Fund: Higher Tax Rate and Benefit Payouts

If the balance of the UI trust fund exceeds 5 percent of total taxable wages in the State (as measured on September 30 of the current year), the lowest tax rate table (Table A) is used to calculate employer rates for the following calendar year. For calendar 2007 and 2008, employers have paid from Table A which imposes a minimum tax rate of 0.3 percent (on the first \$8,500 of annual wages of each employee), or \$25.50 per employee. Approximately 66 percent of employers qualify for the minimum tax rate in the table that is effective for that year. However, the UI trust fund balance on September 30, 2008, \$895 million, fell short by \$53 million of the amount needed to remain in the lowest tax table. Accordingly, employers will pay a higher rate (Table B) in calendar 2009, as was the case in 2006; the lowest tax rate in Table B is 0.6 percent, or \$51 per employee. If the trust fund balance had dipped an additional \$42 million, employers would be paying an even higher rate (Table C).

Exhibit 1 shows the balance of the trust fund on September 30 of each year since 1999, the surcharge imposed or the tax rate table used for each of those years, and the annual payout amounts since 1999. Maryland's seasonally adjusted unemployment rate was 4.6 percent at the end of September 2008. With the average weekly payout at \$303 per claimant during 2008, it is anticipated that calendar 2008 will be the highest annual benefit payout in recent years (calendar 2002 and 2003 average weekly payouts per claimant were \$241 and \$255, respectively).

According to DLLR, in terms of constant dollars, annual benefit payouts during the economic recessions of the 1970s and early 1980s inflicted far more damage on the trust fund's balance.

Exhibit 1
Surcharge/Tax Table, Trust Fund Balance, and Annual Benefit Payouts
1997-2009

Calendar Year	Surcharge/ Tax Table*	Trust Fund Balance as of Prior September 30 (\$ in Millions)**	Annual Benefit Payouts*** (\$ in Millions)
1999	0	\$741.6	\$265.0
2000	0	815.8	261.4
2001	0	882.8	394.5
2002	0	866.9	498.9
2003	0	824.7	512.1
2004	Surcharge: 1.1%	638.5	430.8
2005	Surcharge: 0.8%	703.6	384.7
2006	Tax Table B	883.1	383.5
2007	Tax Table A	1,032.5	433.3
2008	Tax Table A	1,057.8	444.8
2009	Tax Table B	895.4	N/A

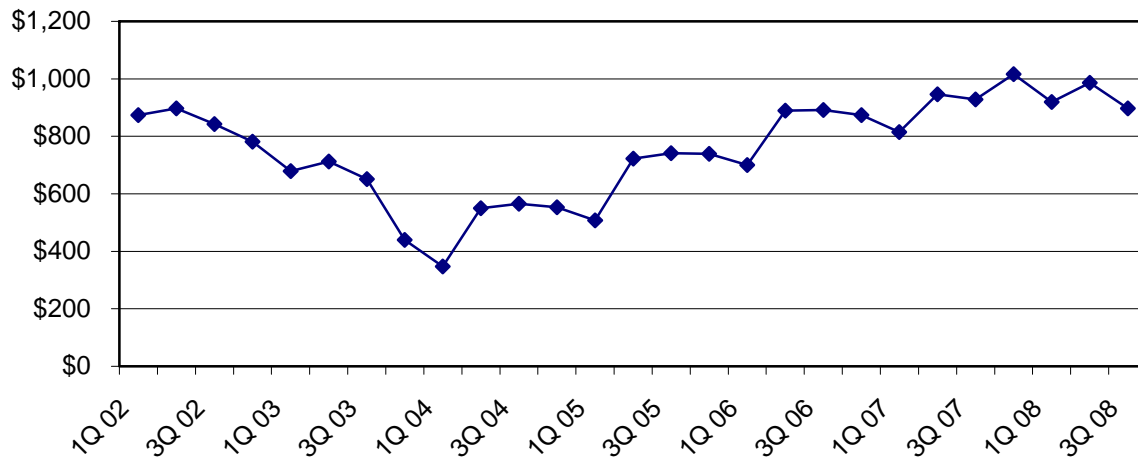
*Tax tables became effective January 1, 2006; prior tax structure used a surcharge when the balance of the trust fund was at an inadequate level.

**Calendar 2003 includes \$142.9 million of Reed Act funds provided by the federal government.

***2008 payout amount is as of September 30, 2008.

Exhibit 2 details quarterly activity in the trust fund since the infusion of the federal Reed Act funds. In the two-year aftermath of September 11, withdrawals from the trust fund significantly outpaced deposits, resulting in a 10-year low in the first quarter of 2004. Conversely, in healthier economic times from calendar 2004 to 2006, deposits to the trust fund were greater than withdrawals leading to a steady climb in the trust fund balance. The recent economic downturn has manifested itself in the fluctuations in the trust fund in 2007 and the first three quarters of 2008. In general, withdrawals have again outpaced deposits, driving down the balance, and triggering a move to Tax Table B for employers.

Exhibit 2
Unemployment Insurance Trust Fund
Quarterly Ending Balances
Calendar 2002-2008
(\$ in Millions)



While Maryland's trust fund remains relatively healthy, other states are projected to deplete their UI funds during 2009 to cover the cost of benefit payouts. With an unemployment rate of 7.7 percent, California forecasts that its fund will hit bottom in March 2009. South Carolina has predicted a similar outcome, given its 7.6 percent unemployment rate. When funds are fully depleted, states may borrow from the federal government's unemployment trust fund. In order to prevent interest from accruing, which must be paid with general funds, loans must be repaid within a year. With an unemployment rate of 8.1 percent, Michigan has already borrowed funds to meet its obligations.

Committee on Unemployment Insurance Oversight

The Committee on Unemployment Insurance Oversight will meet during the fall of 2008 to discuss the status of the trust fund and its adequacy in an economic downturn; it is anticipated that the committee will also discuss the following issues.

Allow Part-time Workers to Collect Benefits

Nationwide, 29 percent of part-time workers received UI benefits compared to 50 percent for full-time workers in a study conducted by the U.S. Government Accountability Office. The September 2007 report also indicates that low-wage workers are over twice as likely to be unemployed as higher wage earners but half as likely to receive unemployment benefits. Thirty states allow UI benefits for part-time workers, according to the National Law Project. Under Maryland law, in order to be eligible for UI benefits, an individual must be able to work, available to work, and actively seeking work. A claimant may not impose conditions and limitations on his or her willingness to work and still be available. Although not explicit in statute, eligibility applies only to full-time work under a 1953 Court of Appeals decision.

The committee supported Senate Bill 328 of 2008 which would have made an individual whose eligibility to work is restricted to part-time work eligible for unemployment benefits, if the individual works predominantly throughout the year on a part-time basis for at least 15 hours per week. The individual would have had to be available and actively seeking work. A part-time worker would not have been considered to be unemployed if working all hours for which the worker is available. The Senate Finance Committee voted favorably on the bill; however, it failed in the House Economic Matters Committee.

Several Benefit Provisions as Part of a Unified Legislative Package

Over the past years, representatives of business and labor have discussed a unified legislative package of benefit changes. Specifically, proposals include implementing a variable duration structure for the receipt of benefits, rather than a fixed 26-week period, and an increase of the maximum weekly benefit amount that is tied to a percentage of the average weekly wage.

While Maryland, like seven other states, uses the 26-week fixed period in which a claimant may be eligible for benefits, the actual average duration is 15 weeks. Senate Bill 982 of 2008 would have allowed a variable duration structure, like 42 states and the District of Columbia entitling a claimant to a total amount of benefits equal to the lesser of 26 times the claimant's weekly benefit amount; or 25 percent of the claimant's base period wages. The Senate Finance Committee did not vote on the measure. The maximum weekly benefit amount in Maryland is \$380, replacing 42.6 percent of the State average weekly wage (\$893 in 2007). The benefit amount was last increased in 2007 from \$340. Proponents for increasing the benefit amount suggest a 54 percent replacement rate. Other states' maximum weekly benefit amounts range from \$210 to over \$570 with about two-thirds tying their benefit amounts to a replacement rate. House Bill 1580 of 2008 would have increased the maximum weekly benefit amount by \$120 over three years. The House Economic Matters Committee did not vote on the measure.

Time Limit to File an Appeal

Maryland, like other states, has an appeal process to allow claimants and employers an opportunity for an administrative hearing on an adverse ruling of claims examiners. Generally, states allow an appeal to the first and second level if the appeal is made within 8 to 30 days of

the decision of the unemployment agency. Maryland law allows an appeal to a hearing examiner in the Lower Appeals Division in DLLR if it is filed within 15 days of a claims examiner's determination and a second level appeal to the Board of Appeals in DLLR if it is filed within 15 days of a hearing examiner's decision. During discussions of a 2008 measure that codified the independence of the Lower Appeals Division from the Board of Appeals, questions were raised about the adequacy of the 15-day timeframe.

Workers Misclassification

As the number of independent contractors grows in the United States (about 7 percent of the workforce in 2005), so does interest in whether workers are properly classified as employees or independent contractors. The classification makes a significant difference in the employment protections and benefits that are available to workers as contractors are typically exempt from certain federal requirements; further, employers do not have to pay unemployment taxes. No single, recognized standard exists to determine how a worker should be classified; court rulings have provided criteria for case-by-case determinations. A common law test attempts to determine the degree of control the contractor has over the end work product. In 2007, the IRS developed a memorandum of understanding to improve information sharing among states and the federal government; 30 states, including Maryland, have signed the agreement.

House Bill 1590 of 2008 would have prohibited employers from misclassifying employees as independent contractors and authorized DLLR to investigate complaints regarding possible misclassification of workers and issue citations for noncompliance. The House Economic Matters Committee voted unfavorably on the bill. Recently, DLLR created a Workplace Fraud Working Group to gather input from stakeholders in order to develop a comprehensive strategy that may include outreach and education to employers and workers, coordinated enforcement of existing laws, and legislative proposals to enhance penalties.

Persons Exempt from Coverage

An individual performing services for a business in return for compensation is covered under UI unless the individual is an independent contractor or specifically exempted by law. Independent contractors are not covered if the individual is free from control and direction over his/her performance; the individual customarily is engaged in an independent business of the same nature as that involved in the work; and the work is outside of the usual course of business of the person for whom the work is performed. Most exemptions under Maryland law mirror Federal Unemployment Tax Act exemptions, including barbers and beauticians, taxicab drivers, election workers, church employees, and certain government employees. However, Maryland has enacted State-only exemptions (*e.g.*, certain owner operator tractor drivers). Proposals during the 2008 session would have exempted music teachers providing instruction at music stores and certain seamstresses. The House Economic Matters Committee did not vote on these proposals.

Business Regulation

Regulation of Cranes and Crane Operators

A series of high-profile crane fatalities has raised interest in the regulation of cranes and the training and certification of crane operators. The Department of Labor, Licensing, and Regulation has adopted regulations to improve safety; national professional organizations also offer certification options for operators, riggers, and signalpersons.

Background

A March 15, 2008 incident in New York City killed seven when the crane's tower, crane, and boom collapsed as it was being "jumped," a process of raising a crane from one height to another. In Maryland, a worker was killed in Annapolis on April 30 after becoming trapped between two sections of crane as it was being dismantled. The Occupational Safety and Health Administration (OSHA) estimates that nearly 90 construction-related crane fatalities occur each year. A 2006 analysis of OSHA data determined that nearly one-third of crane fatalities result from a worker being struck by the crane's load. Other common causes of crane fatalities include electrocution and crushing. In Maryland, the April 30 incident has been the only crane-related fatality in the last five years, though three serious injuries have been reported.

Federal-State Role in Establishing and Enforcing Safety Standards

OSHA standard 1926.550, which establishes general requirements for cranes and derricks, requires an employer to designate a competent person to inspect all machinery and equipment to make sure it is in safe operating condition. The federal standard also establishes requirements for annual inspection.

The State of Maryland is 1 of 15 states granted final approval from OSHA to independently establish and enforce occupational safety and health standards. Under the State Plan, Maryland Occupational Safety and Health (MOSH) has jurisdiction over all public and private sector places of employment, with certain exceptions. As part of this agreement, the State Plan must be at least as effective as corresponding federal standards. The State must also meet established staffing levels and participate in federal data collection and automation efforts.

Under the State Plan, MOSH has adopted standards unique to the specific needs of Maryland employees and employers. In order to standardize requirements and increase compliance, MOSH has adopted for State use Title 29 Code of Federal Regulations, which establishes occupational safety requirements for general industry, construction, and agriculture. These federal standards include the preceding crane inspection guidelines, which are enforced by

the State compliance unit. MOSH indicates that they have conducted 30 inspections since 2005 that have resulted in citation; a total of 44 violations were identified in these cases.

In addition to the federal guidelines, Maryland law requires each employer to develop an employee safety training program for operators of power equipment, including cranes, to inform these employees of the limitations and use, rated load capacities, and special hazards specific to the operation of power equipment. This training program may not be construed to require licensing, registration, or certification of an operator of power equipment.

State Regulations Proposed to Increase Training and Inspection

Beginning in May 2008, the Maryland Commissioner of Labor and Industry convened a workgroup of construction, labor, and safety representatives to review State regulation of cranes, derricks, and hoisting equipment. The recommendations of the workgroup were incorporated into the regulations recently proposed by the Department of Labor, Licensing, and Regulation with the purpose of preventing incidents resulting from the operation of cranes in construction, demolition, and maintenance. The proposed regulations establish new procedures for erecting, operating, and dismantling of cranes, including:

- **Crane Operator Requirements:** An operator must participate in training and pass a written examination on the principles of safe crane operation prior to operating a crane. An operator must successfully complete a physical examination by a licensed physician twice each year and screen negative for substance abuse. An employer may elect to accept certification from a nationally recognized program as an alternative to the preceding requirements.
- **Rigger and Rigging Requirements:** Training and examination requirements are established for individuals who rig loads, with progressive training and experience requirements based on the level of responsibility. For all three levels of riggers, certification may be substituted for employer training. All riggers must screen negative for substance abuse, with master riggers additionally required to successfully complete a physical examination.
- **Crane Inspection:** New and altered cranes are subject to initial inspection prior to operation, after which the crane must be inspected every year to determine that it continues to meet standards for operational safety. Daily inspections must also be conducted while the crane is in use in order to determine that the crane meets manufacturer specifications.
- **Tower Cranes:** A qualified person must determine safe integration and assembly procedures prior to erection or modification of a tower crane. Manufacturer's instructions and related information must be available when a tower crane is erected, dismantled, jumped, or reconfigured. An employer must establish safe procedures for the site as supervised by a master rigger. A job safety briefing must be conducted each day prior to specified activities.

Certification and Licensure Options Available in Other Jurisdictions

Fifteen states and six cities have enacted licensing requirements for crane operators; an additional four states have considered legislation to require licensure. These jurisdictions are listed in **Exhibit 1**. The majority of these jurisdictions recognize certification by the National Commission for the Certification of Crane Operators (NCCCO) as a path to licensure. To qualify for NCCCO certification as a crane operator, an applicant must be at least 18 years old, meet medical requirements, comply with the commission's substance abuse policy, pass both a written and a practical examination, and comply with the code of ethics. Certificate holders must pass a recertification examination and continue to meet other requirements as a condition of renewal.

Maryland House Bill 699, which was introduced in the 2008 session, would have required an individual to be licensed by a State Board of Crane Operators as a condition of operating a crane in the State. An applicant for licensure would have been required to have 1,000 hours of experience and hold a certificate from a testing and certification program. The bill was withdrawn.

Exhibit 1 Licensing Requirements for Crane Operators by Jurisdiction

<u>States that License</u>	<u>States that Recognize NCCCO Certification</u>	<u>States that Have Considered Licensing</u>	<u>Cities that License</u>
Connecticut	California	Florida	Chicago
Massachusetts	Hawaii	Iowa	Los Angeles
New York	Minnesota	Maryland	New Orleans*
Oregon	Montana	Pennsylvania	New York City
Rhode Island	Nevada		Omaha*
	New Jersey		Washington, DC
	New Mexico		
	Utah		
	Washington (as of 2010)		
	West Virginia		

* Denotes a city that requires or recognizes NCCCO certification.

Sources: National Commission for the Certification of Crane Operators (NCCCO); National Conference of State Legislatures.

Business Regulation

Regulation of Junk Dealers and Scrap Processors

Theft of items that can be resold to scrap metal processors or junk dealers has become a national epidemic, costing businesses, nonprofits, churches, and governments thousands or millions of dollars. In Baltimore County alone, crimes involving valuable metal theft increased by over 600 percent between 2005 and 2007. Legislation proposed in the 2008 session (and anticipated to be reintroduced in 2009) would have expanded the current system used by junk dealers and processors to report sales to local police so that more items and the identity of the individuals who sold the scrap would be reported.

Wide-scale Scrap Metal Theft Prompts Legislation

The global demand for nonferrous scrap metals, particularly copper, has helped fuel a widespread increase in the theft of a large variety of metal-based goods, such as wiring, cemetery plaques, irrigation pumps, catalytic converters, appliances, and even bleachers. Reduced domestic generation of scrap, combined with increased demand from developing countries for construction-related metals such as aluminum and copper, created a strong market for scrap metal.

However, metal prices are plummeting in response to the global economic crisis; industrial experts are predicting substantial copper surpluses in 2009, forcing prices even lower. Whether the decline will slow the rate of scrap metal theft remains to be seen. Law enforcement officials link some of the increased theft of scrap metal with the growing use of methamphetamine, since scrap metal sales provide a source of quick cash to purchase the drug.

The issue has attracted the attention of Congress which considered legislation earlier this year that would establish recordkeeping requirements on copper recyclers and impose a \$10,000 civil penalty for violations. More municipalities and states are considering or have enacted legislation aimed at curbing the resale of stolen items; 26 states either regulate scrap metal sales or criminalize scrap metal theft. Several states adopted stricter standards for reporting the sale of scrap metal or instituted stiffer penalties for violations (or both). Tennessee's new law, for example, prohibits a scrap dealer from buying or dealing in scrap without first registering with the state Department of Commerce and Insurance and requires an individual who sells scrap metal to present the dealer with photo identification and a thumbprint.

Statewide theft statistics are unavailable for Maryland. The theft affects a broad array of individuals and businesses – farmers, telecommunications companies, public utilities, home builders, local governments, high school athletic teams, and individuals whose family members' gravesites have been vandalized. For example, in the last two years, thieves stole approximately \$100,000 worth of vases and bronze markers from the Eastern Shore Veterans' Cemetery, as

well as 100 bronze vases at Trinity Memorial Gardens in Waldorf, and two dozen bronze vases and urns from a Crownsville cemetery.

Proposed 2008 Legislation Likely to Return During the 2009 Session

In response to the increasing thefts of catalytic converters and nonferrous metals, the General Assembly considered legislation intending to address the problem. During the 2008 session, Senate Bill 521, “Junk Dealers and Scrap Metal Processors – Required Records,” would have added additional metals and items to the definition of junk and scrap metal and would have established extensive recordkeeping requirements for licensed junk dealers and scrap metal processors that purchase scrap in Maryland. The bill would have applied to all junk dealers and scrap metal processors in the State, regardless of whether local regulation existed, and regardless of whether the scrap processor was licensed under the Transportation Article as an auto dismantler and recycler. The inclusion of auto dismantlers and recyclers already regulated under the Transportation Article proved to be particularly controversial and will likely continue to be at issue when the General Assembly considers similar legislation during the 2009 session.

Business Regulation

Maryland Automobile Insurance Fund – Surplus

Legislation allowing Maryland Automobile Insurance Fund (MAIF) policyholders to purchase personal lines automobile insurance through an installment basis, as has been introduced for multiple prior years. While MAIF's surplus has grown consistently from 2002 to 2007, it is anticipated to be in a period of decline as the number of policies issued by MAIF has increased since 2007 and the investment environment has grown more challenging.

Background

In 1972, the General Assembly made automobile insurance compulsory in Maryland. The Maryland Automobile Insurance Fund (MAIF), an independent agency of the State, was created that same year to insure drivers who could not obtain insurance in the private market and to protect the public from damages caused by them. Only Maryland residents who have been refused policies by at least two private insurers or who have had their policies cancelled may qualify for MAIF policies, making MAIF the insurer of last resort. A MAIF policy may be sold by any insurance producer (agent) qualified to do business in Maryland. As is the case with most private insurers, an insurance producer who sells a MAIF policy receives a commission on the premium paid for the policy. Unlike private insurers, MAIF is precluded by State law from financing its own premiums or accepting premium payments on an installment basis. As a result, the bulk of its policies (which must be on a 12-month basis) are financed through premium finance companies.

There are considerable fees and charges associated with financing a premium through a premium finance company. The allowable finance charge under a premium finance agreement is 1.15 percent for each 30 days, charged in advance. In addition to the finance charge, a premium finance company may charge an initial service fee, an electronic payment fee, and other fees associated with delinquency, cancellation, reinstatement, or dishonored checks. Since these costs can add significantly to the cost of an insurance policy, legislation authorizing MAIF to accept premiums on an installment basis has been introduced every year since the 2005 session, as well as in many other years going back to the late 1980s.

Legislation Authorizing MAIF to Accept Premiums on an Installment Basis

Senate Bill 603 of 2008 would have authorized MAIF to accept premiums on an installment basis on 12-month personal lines policies. An insured would have to make a down payment of at least 25 percent of the total premium and a maximum of six installments; the processing fee would have been capped at \$8 per installment. Premium finance companies generally accept an 11 percent down payment with 10 installments. MAIF is one of a kind with

no other state having a separate agency to handle high-risk drivers; other states use an assigned risk plan that requires each insurer operating in their respective state to insure a portion of the risky drivers. The percent down payment varies among the state assigned risk pools (from 15 to 40 percent); among the surrounding states, Virginia requires 40 percent, while West Virginia, Delaware, New York, and DC allow 25 percent; Pennsylvania and New Jersey require 30 percent. While the actual cost of an insurance premium depends on where the vehicle is “housed” and the age and driving record of the driver (among other factors), the average premium for a MAIF liability only policy averages over \$1,300 per year; a full coverage MAIF policy averages over \$2,500 per year.

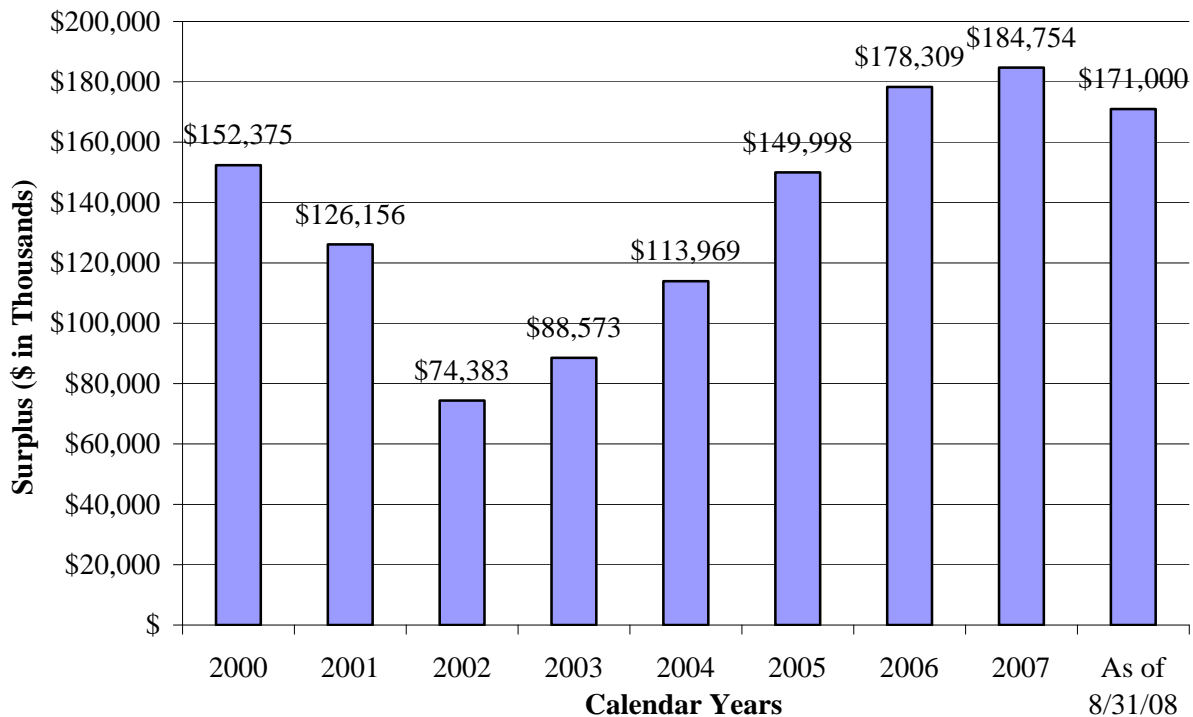
Senate Bill 603 would have imposed additional requirements on MAIF, insurance producers, premium finance companies, and the Maryland Insurance Commissioner. Similar legislation is anticipated to be introduced during the 2009 session.

Surplus History of MAIF’s Insured Division

As the surplus of MAIF’s Insured Division has increased over the past years, there have been discussions in the General Assembly about whether and how any excessive amount should be used for other purposes. Recent history indicates that the surplus can fluctuate, sometimes substantially, between years. **Exhibit 1** shows the changes to MAIF’s surplus in recent years. Despite a growing surplus after calendar 2002, evidence indicates that the surplus could be in a period of decline. Generally, MAIF’s surplus grows and declines with the economy, and remains cyclical. As the number of policies issued by MAIF declined between calendar 2003 and 2007, MAIF’s surplus increased to over \$184 million at the end of 2007. In contrast, as MAIF’s policies increase, the surplus declines as is currently the case; that is, in 2007 the number of policies issued by MAIF increased and the surplus subsequently began to fall (to a little over \$171 million, as of August 31, 2008).

According to MAIF and Maryland Insurance Administration (MIA) response to a 2008 *Joint Chairmen’s Report* (JCR) request, as of August 31, 2008, MAIF surplus has decreased to \$171 million, a 10 percent decline since October 2007 and a 7.4 percent decline since the end of calendar 2007. Recent economic turmoil could lead to further declines in the surplus. The report states that “There is certainly a point at which an insurance company’s surplus is excessive, even for a unique insurer like MAIF. Based on current information, however, there is no reason to believe that MAIF’s current surplus is unreasonable. By all relevant measures, MAIF’s surplus level is consistent with and in many cases far less than that maintained by other automobile insurance companies operating in Maryland.”

Exhibit 1
MAIF's Insured Division Surplus
2000-2008



Source: Maryland Automobile Insurance Fund

Proposed Rate Reduction

In the summer of 2008, MAIF requested approval by MIA for a 4.9 percent rate reduction, an estimated \$5.7 million reduction to earned premiums. However, it is expected to have a smaller impact on the surplus. In October 2008, MAIF requested and was granted a 45-day deferral of a decision on this rate reduction request to allow MAIF the opportunity to consider the impact of current economic conditions. A decision on the rate reduction is expected in mid-November 2008. If approved this would be the third rate reduction since January 2007.

Evaluation Method of MAIF's Surplus

As part of the response to the JCR request, MAIF and MIA outlined a formal method by which the surplus of the Insured Division of MAIF will be evaluated for excessiveness and corrective actions taken if necessary. The factors by which MAIF's surplus should be evaluated

include (1) the ratio of surplus to assessment trigger; (2) surplus under risk based capital standards; (3) ratio of premium to surplus; (4) external economic factors; (5) trends in automobile insurance; (6) 24-month financial projections; (7) type of insurance; (8) quality of risk; (9) geographic scope of policies; (10) market share and competitive position; (11) best interest of customer; and (12) any other information as determined by the Commissioner. This method of evaluation contains some of the same type of information that MIA uses to analyze other insurance companies but also contains other factors specific to MAIF.

The report also describes a planned formal review process for examining the reasonableness of MAIF's surplus, which is in addition to the responsibility of MAIF's Board of Trustees to review the surplus. Specifically, MIA would require MAIF to assess its surplus and provide information to MIA. MIA would then conduct a review of MAIF's surplus. If the surplus is determined to be excessive, MIA would request MAIF develop a plan to reduce the surplus, including a description of methods and a timeline. A memorandum of understanding to formalize this process is expected to be signed by December 15, 2008. The initial submission of this information by MAIF to MIA would occur by May 1, 2009, with a decision by the Commissioner by June 30, 2009. This process would occur on these dates annually thereafter.

Business Regulation

Debt Management and Debt Settlement Services

Although Maryland regulates debt management companies, debt settlement companies are allowed to operate in the State without direct regulation. Debate as to whether consumer protections in this industry are needed is ongoing.
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Background

Debt management and debt settlement companies provide assistance to debt-laden consumers by offering to negotiate with a consumer's creditors to achieve more favorable terms for the consumer. Beyond this basic similarity, however, the specific services that debt management and debt settlement companies provide to consumers are quite different.

Under a typical debt management plan, a debt management company negotiates with a consumer's creditors to obtain reduced monthly payments, interest rates, and fees for the consumer. The company then consolidates the consumer's monthly payments to creditors, and the consumer makes a single payment to the debt management company. After deducting its commission, the debt management company distributes the funds to the consumer's creditors.

Debt settlement companies, on the other hand, typically do not handle or manage a consumer's funds. Instead, they direct the consumer to set aside a certain amount each month into an account established either by the company or the consumer. The debt settlement company takes its fees from those funds, but the funds are not distributed to the consumer's creditors. The funds are held in the account while the debt settlement company attempts to negotiate lump-sum settlements with the consumer's creditors.

In Maryland, debt management companies are subject to the licensing and regulatory provisions of the Maryland Debt Management Services Act. The Commissioner of Financial Regulation is responsible for carrying out and enforcing the Act. Although more than 30 states regulate debt settlement companies, Maryland does not.

Regulation of Debt Management Companies

In response to consumer complaints about the practices of various companies offering credit counseling services, the General Assembly, in 2003, passed the Maryland Debt Management Services Act. Subject to certain exemptions, the Act prohibits a company from providing debt management services without a license. The Act includes various disclosure requirements, prohibits debt management companies from engaging in certain practices, and limits the fees a company may charge for debt management services.

As originally enacted, the Act only allowed tax-exempt, § 501(c) nonprofit organizations to provide debt management services in the State. In recent years, however, the Internal Revenue Service (IRS) revoked the tax-exempt status of many debt management companies, including several companies operating in Maryland. In taking this action, the IRS determined that, although the services provided by debt management companies have an educational component, the companies do not serve an exclusively charitable or educational purpose. According to the Commissioner of Financial Regulation, approximately 6 of the 36 debt management companies licensed to operate in Maryland lost their § 501(c) tax-exempt status. As a result, the commissioner revoked the licenses of those companies.

During the 2008 session, the General Assembly amended the Debt Management Services Act by removing the § 501(c) requirement. In addition to authorizing for-profit debt management companies in Maryland, Chapters 605 and 606 of 2008 strengthened the Debt Management Services Act in a number of ways. As amended, the Act prohibits debt management companies from entering into a debt management services agreement with a consumer unless the company first determines that the services are suitable for the consumer and the consumer will be able to meet the payment obligations under the agreement. In addition to several other changes made by Chapters 605 and 606, the Act now contains stronger consumer education provisions and requires that debt management counselors receive comprehensive training in consumer counseling, personal finance, budgeting, and credit and debt management.

Since October 1, 2008, the effective date of Chapters 605 and 606, one for-profit company has applied for a license to operate as a debt management services provider in Maryland. As of late October 2008, the commissioner has not taken any action on that application.

Regulation of Debt Settlement Companies

The Commissioner of Financial Regulation estimates that approximately 25 to 35 debt settlement companies operate in Maryland. Debt settlement companies generally are not subject to the licensing and regulatory provisions of Maryland's Debt Management Services Act. Consumer complaints concerning debt settlement companies and reports of some companies' unscrupulous business practices, however, have led to a debate among policymakers and various interest groups regarding the need to regulate, and the method of regulating, debt settlement companies in the State.

A 2005 report prepared by the National Law Center, *An Investigation of Debt Settlement Companies: An Unsettling Business for Consumers*, notes that debt settlement companies generally operate as for-profit businesses. They tend to charge consumers large administrative and upfront fees, which deplete the funds that consumers set aside for payment of their debts. Some debt settlement companies even advise consumers to stop paying their creditors, reasoning that this strengthens a consumer's negotiating position. Meanwhile, interest continues to accrue, penalties are assessed, and in some cases, consumers face debt collection lawsuits. As the report points out, few consumers actually complete debt settlement programs.

At least 30 states regulate debt settlement companies in some manner. The majority of those states require debt settlement companies to be licensed or registered before they may provide debt settlement services. Of the states that have a licensing or registration requirement, many limit the fees debt settlement companies may charge and require debt settlement companies to post performance bonds. Some states require that providers of debt settlement services be nonprofit entities, while a few states altogether ban the practice of providing debt settlement services.

Legislative Efforts in Maryland

The General Assembly considered legislation to regulate debt settlement companies during the 2008 session. House Bill 1223 of 2008, which was referred to an interim study by the House Economic Matters Committee, would have amended Maryland's Debt Management Services Act to include debt settlement companies in the Act's licensing and regulatory scheme. As introduced, the bill would have required that debt settlement companies obtain a license to operate in the State, meet bonding requirements, and submit annual reports to the commissioner. The bill also would have required that debt settlement companies enter into a debt settlement agreement with a consumer and disclose certain information before providing debt settlement services. Another provision in the bill would have imposed limits on the fees charged by debt settlement companies.

The commissioner estimated that the bill's fee restrictions would lead to a significant reduction in the number of debt settlement companies operating in the State. The commissioner estimated that only 5 to 10 companies currently operating in Maryland would continue to operate under the bill's licensing and regulatory scheme. The commissioner warned that this could lead to funding problems in the commissioner's enforcement efforts, as the commissioner largely relies on licensing fees for funding. Without a new source of funding, the licensing fees from a small number of companies likely would not provide sufficient funding to offset the anticipated increase in the commissioner's costs of regulating the industry.

Business Regulation

Private Sector Labor

Legislators may see various labor-related proposals from the 2008 session resurface in 2009. These proposals include required breaks for workers, increased financial recovery for underpaid employees, and penalties and new rules related to misclassifying employees as independent contractors. In addition, by January 1, 2009, the Department of Legislative Services will have completed its study of the economic impact of the recently enacted State living wage law.

Anticipated Labor and Employment Legislation

Misclassification of Employees

One of the most controversial bills in the 2008 session related to the appropriate classification of workers as independent contractors or employees. Individuals classified as independent contractors are not covered for workers' compensation or unemployment insurance, and are not entitled to certain employment protections (*e.g.*, anti-discrimination laws) provided by law to regular employees. In addition, employers are not required to pay payroll and unemployment insurance taxes or withhold income taxes, causing a revenue loss for both the State and federal government if the workers are not aware that these taxes are owed. It is unknown how many workers in Maryland are misclassified.

Legislation sponsored by the Department of Labor, Licensing, and Regulation (DLLR) in 2008 would have created a presumption of employment and put the burden of proof on the employer to prove that a worker is an independent contractor. House Bill 1590 also proposed several types of penalties on employers who misclassify employees. The bill also enabled the employee to sue the employer. That bill failed but is under discussion by a workgroup of contractors, union leaders, and advocacy groups that was created by DLLR in the 2008 interim. Among the key points of the group's discussion is the treatment of employers who misclassified an employee by mistake, versus employers who knowingly misclassified to evade taxes and insurance payments.

Misclassification has captured the attention of several states, including Massachusetts, Michigan, New Jersey, New York, Connecticut, Utah, and Vermont, which have established task forces to study this issue.

Shift Breaks

In 2007 and 2008, lawmakers introduced legislation that would require employers to provide a nonworking break for employees. House Bill 654 of 2008, as introduced, would have established a 30-minute break for each employee who works more than five consecutive hours or

15 minutes for each employee who works up to six consecutive hours. These requirements could be waived by mutual consent. An employee could sue an employer who does not comply with the provisions of the bill. The bill did not apply to employers who have less than 50 employees or to individuals who are licensed by the State to provide mental health services or care for individuals with disabilities.

The legislation drew opposition from members of the business community, which stated that the bill would not allow flexibility in the workplace and would be difficult to administer. As amended by the House Economic Matters Committee, House Bill 654 would have provided an exemption for emergencies, applied the bill to State government, and altered the number of hours required for a 30-minute break from “more than five” to six. It also would have authorized the Commissioner of Labor and Industry to exempt categories of employment from the requirements of the bill. House Bill 654 was not reported out of committee.

Wage Violations

If an employer pays an employee less than the required minimum wage (\$6.55 per hour) or overtime pay (1.5 times the regular pay rate), the employee may sue the employer directly to recover the difference or request action by the Commissioner of Labor and Industry, who can ask the Attorney General to bring an action. In many cases, the commissioner mediates the case out of court. If the case goes to court, the employee may also recover reasonable counsel fees and other costs (undefined by law) at the court’s discretion.

Maryland law prohibits an employee from making groundless or malicious complaints or testifying in bad faith against an employer. The criminal penalty of up to \$1,000 for violations committed by either the employer or employee is rarely invoked.

House Bill 1392 of 2008, which was reported favorably by the Economic Matters Committee and passed the House but received no action in the Senate, would have established civil penalties for minimum or overtime pay violations, as well as violations by the employee. As amended by the Economic Matters Committee, the bill would have imposed maximum fines of \$500 for the first violation, \$1,000 for a second violation, and \$1,500 for a third violation. It also would have required the court to award counsel fees and interest on back pay to the employee if the employer was found to be in violation.

Flexible Leave

Chapter 644 of 2008 authorizes employees to use paid leave that the employee has earned for the illness of an immediate family member. The law applies to employers with more than 15 employees and provides that the terms of the employer’s policy or collective bargaining agreement regarding the use of paid leave must still be followed. Proposals may arise in the 2009 session to clarify aspects of this law, including a definition of illness. A few states, including Hawaii, Connecticut, Washington, and Maine, allow similar use of paid leave, though some are restricted to serious health conditions or serious illness. Connecticut and Maine define

serious illness as “an illness, injury, impairment or physical or mental condition that involves inpatient care in a hospital, hospice or residential care facility, or requires continuing treatment or continuing supervision by a health care provider.”

Living Wage Study

Chapter 284 of 2007 requires State contractors to pay a living wage to their employees, subject to certain exemptions and restrictions for small businesses and employers in specified sectors. The living wage was initially set at \$11.30 in the five counties in the Baltimore-Washington corridor and \$8.50 for all other areas of the State. Under authority provided under Chapter 284, the Commissioner of Labor and Industry subsequently adjusted those rates to \$11.72 and \$8.81, respectively, to account for inflation.

Chapter 284 also requires the Department of Legislative Services (DLS) to conduct a study of the fiscal and economic impact of the living wage on the public and private sectors and report its findings by January 1, 2009. DLS expects to complete the mandated study by the designated deadline. Preliminary findings indicate that DLLR has implemented monitoring and enforcement mechanisms with limited disruption, and State procurement officers have not experienced undue burdens in implementing the living wage mandate. The potential economic effects on State contractors will be addressed in the final report.

Public Safety

Sex Offenders

Legislation is expected during the 2009 session to make statutory changes to comply with the 2006 federal legislation on sex offenders, commonly referred to as the “Adam Walsh Act,” and the federal implementing regulations. Failure to substantially comply with federal requirements could result in a loss of 10 percent of federal Byrne Justice Assistance grant funding.

Background

Following several high-profile murder and sexual assault cases involving child victims, far-reaching State and federal legislation has been enacted to more strongly punish and more closely monitor sex offenders. The federal Sex Offender Registration and Notification Act (SORNA), enacted as Title I of the Adam Walsh Child Protection and Safety Act of 2006 (P.L. 109-248), requires conformity by the states with various aspects of sex offender registration provisions, including registration of specified juvenile offenders, collection of specific information from registrants, verification, duration of registration, access to and sharing of information, and penalties for failure to register. The final guidelines/regulations were issued on July 2, 2008. July 27, 2009, is the deadline for substantial implementation of SORNA’s requirements by all jurisdictions.

In addition, on September 27, 2008, Congress passed the Keeping the Internet Devoid of Sexual Predators (KIDS) Act of 2008 (S. 431), which expands upon SORNA’s requirements relating to online identifiers used by sex offenders. Guidelines and regulations for this Act have not yet been developed.

Federal Requirements

Under SORNA’s final guidelines/regulations, it appears that the following modifications to current State law, among others, would be needed to comply with SORNA.

Length of Registration

The federal law divides the classes of sex offenders into a three-tiered system. Under that system, registration is for 15 years, 25 years, or life, depending on whether the offense is classified as Tier I, Tier II, or Tier III, respectively. Under current State law, Maryland classifies its sexual offenders into four classifications, and registration is for 10 years or life, depending on the offense. Additionally, under current Maryland law, most registrants are required to re-register every six months, while Tier I offenders in the federal system must re-register

quarterly. Although states are not required to mirror the federal tiers, it may be necessary to significantly revamp Maryland's classification system to meet the minimum federal requirements.

Registration Deadlines

SORNA requires an offender to appear in person not later than three business days after each change of name, residence, employment, or student status and inform the jurisdiction in which the person is required to register of all changes in information required in the registry. Current Maryland law allows written notice within five days after the change occurs. The federal law also requires that initial registration must occur before release, while Maryland law allows registration "on or before" the date of release.

Application of Registration Requirement to Juvenile Offenders

The federal law applies to a juvenile offender adjudicated delinquent if the offender is 14 years of age or older at the time of the offense and the offense adjudicated was comparable to or more severe than 18 U.S.C. § 2241 (Aggravated Sexual Abuse) or an attempt or conspiracy to commit such an offense. Under current State law, registration requirements only apply to juvenile offenders who have been tried as adults.

Registry Information

The federal Act requires that the registry contain extensive information for each offender, including palm prints, Internet identifiers and addresses, travel and immigration documents, professional licensing information, vehicle information, and a physical description of the offender. This information is not required to be included in the registry under current Maryland law.

Homeless Persons

Because SORNA defines the term "resides" to mean "the location of the individual's home or other place where the individual habitually lives," the residency registration requirements are extended to circumstances where the offender is homeless, living on the street, or moving from shelter to shelter, or when the place of residence itself moves from place to place, such as a mobile home, trailer, or houseboat. Accordingly, sex offenders must register (1) in any jurisdiction in which they have a home; and (2) in any jurisdiction in which they habitually live (even if they have no home or fixed address in the jurisdiction). Maryland law does not currently account for the homeless offender population.

Retroactivity

The Act applies to all sexual offenders, including those offenders convicted prior to the enactment of SORNA (July 27, 2006) or prior to a particular jurisdiction's implementation of the SORNA requirements. Jurisdictions do not have to seek out pre-SORNA convicted sex offenders and re-register them if their previous registrations have expired. If a person re-offends or re-enters the judicial system for any crime, the individual will need to register under SORNA guidelines. Generally, Maryland offenders need not register if their offense occurred prior to October 1, 1995. Exceptions are made for individuals who were under the supervision of the criminal justice system on October 1, 2001, or have out-of-state registration responsibilities.

Compliance Issues

According to the National Conference of State Legislatures, all state submissions, to date, have been rejected as not being in "substantial compliance" with SORNA.

Failure to comply with SORNA puts a state at risk to lose 10 percent of Byrne Justice Assistance grants, which all states use to pay for such things as drug task forces, anti-gang units, police overtime, and other law enforcement activities. The Byrne formula grants program has been reauthorized from fiscal 2009 through 2012 at fiscal 2006 funding levels (\$1.095 billion annually). Although the fiscal 2009 Byrne funding to the states has been reduced by 67 percent of anticipated funding levels, this program (including formula grants) has been reauthorized by Congress through fiscal 2012 at fiscal 2006 funding levels. Maryland's federal grant funding levels through Byrne is shown in **Exhibit 1** for recent State budget years.

Exhibit 1

	<u>FY 2006</u>	<u>FY 2007</u>	<u>FY 2008</u>	<u>FY 2009</u>	<u>FY 2010</u>
Byrne Funding	\$7,104,375	\$5,681,080	\$6,499,053	\$2,144,688*	\$7,104,375**
Amount at risk for SORNA noncompliance				\$214,469*	\$710,438**

* Reflects an assumed 67 percent reduction in grant income for fiscal 2009, based on the national funding level reduction.

** Reflects an assumed return to fiscal 2006 funding levels.

During the 2008 session, a departmental bill (House Bill 1538) was introduced at the request of the Department of Public Safety and Correctional Services to conform State sexual offender notification and registration provisions to SORNA. The provisions of the bill were also

submitted to the federal Office of Sex Offender Sentencing, Monitoring, Apprehending, Registering, and Tracking (SMART Office) as a proposed compliance submission should the bill pass. The bill did not pass, and the SMART Office found that, while Maryland's proposed changes and efforts were commendable, they would not bring the State into substantial compliance under the Act. Another departmental bill based on both the 2008 response from the SMART Office and the final federal guidelines is expected to be introduced during the 2009 session.

Public Safety

State Prison System Update

The Department of Public Safety and Correctional Services continues to deal with a variety of issues, including prison violence and gangs, community corrections, and correctional officer recruitment and retention. Discussion of each of these issues is likely during the 2009 session.

Task Force to Study Prison Violence in Maryland

The Task Force to Study Prison Violence in Maryland, created by Chapter 518 of 2007, held its first meeting in June 2008. The task force, co-chaired by Senator Verna Jones and Delegate Christopher Shank, is divided into three subcommittees to address (1) environmental and health issues; (2) gangs, contraband, and drugs; and (3) best practices.

Over the course of three meetings, the role of gangs, effective programming for inmates, and sufficient staffing in correctional facilities have been primary topics of discussion. Preliminary concepts developed by the task force include the following:

- the State cannot address the problems within the prisons without discussion of the culture of prison life and life outside of prison;
- there is a need for standard processes for identifying and addressing contraband across the State prison system;
- inmates must be an active part of the discussion for reform and change; and
- the State needs to increase programming and treatment for inmates, including education programming, instruction in the arts, vocational training, and substance abuse treatment.

Research conducted by the best practices subcommittee has indicated that Maryland currently has a number of practices in place to curb prison violence; however, because these practices are still relatively young in their implementation, it is too soon to tell how well they are working. Additional suggestions were to increase information sharing between criminal justice agencies and gather better information up front in terms of inmate needs, behavior, and history.

Finally, the task force also heard a presentation on Maryland's Gang Kaizen, a statewide security initiative that brings together a variety of criminal justice organizations to curb gang violence, and its recommendations for dealing with statewide gang-related issues. With the participation of 50 criminal justice stakeholders and 75 subject matter experts, the Kaizen

identified four critical areas of focus: (1) information sharing; (2) investigative/enforcement; (3) enhanced training; and (4) prevention/intervention resources. Initial actions identified by the group referenced the increased transfer of data between law enforcement and corrections and between State and local entities. The group also drafted potential legislation regarding gang validation to be introduced during the 2009 session and developed a new gang training program required for all law enforcement and correctional staff.

A final report and recommendations are due to the Governor and the General Assembly by December 31, 2008.

Community Corrections

The Department of Public Safety and Correctional Services (DPSCS) is moving forward with plans to expand and reorganize the scope of its community corrections system. At the core of the expansion plan is the transfer of the entire pre-release system and contract halfway houses from the Division of Correction (DOC) to the Division of Parole and Probation (DPP). The transition is to occur in multiple phases and be completed by the start of fiscal 2012. The purpose of the new community corrections system is to create a more streamlined transition from prison to the community through the use of better community connections and increased reentry services.

The other component of the new community corrections system is to create a halfway back sanctioning model, which would allow DPP to use the pre-release facilities as sanctioning facilities for offenders who violate conditions of release. This is a secondary goal and is still in the early development phase. Creation of the halfway back sanctioning model would require support of the Judiciary, the Maryland Parole Commission, and statutory changes.

There are still a number of issues that indicate a need for close monitoring of the progress of this program. A clear implementation plan has not been created for the halfway back sanctioning model, and it is unknown how intermediate sanctions might impact the offender population. There is also some concern in regard to a community supervision agency being responsible for custodial functions. Finally, there is the potential for cost increases and negative impacts on available bed space by expanding service provision.

Correctional Officer Recruitment and Retention Efforts

Issues with correctional officer recruitment and retention have plagued the department for a number of years and have resulted in significantly increased overtime expenditures and correctional officer resignations. Fiscal enhancements implemented in fiscal 2006 combined with additional efforts by DPSCS appear to be having a positive effect on staffing needs.

Exhibit 1 shows a nearly 90 percent increase in the number of applicants tested and a 48 percent increase in the number of Correctional Officer (CO)-I applicants interviewed between calendar 2005 and 2006. The number of CO-I applicants hired by DOC also increased by 26 percent between calendar 2005 and 2006. The department has been able to maintain increased levels of recruitment for calendar 2007, and although the calendar 2008 data is only provided through September, the monthly averages indicate an applicant pool of nearly 6,900 and DOC hires close to 800. In addition, the monthly average attrition rate for CO-I, CO-II, and Sergeant positions has decreased from 1.3 percent in calendar 2007 to 1.0 percent in calendar 2008, indicating increased retention.

Exhibit 1
Correctional Officer Recruitment Efforts
Calendar 2004-2008

	<u>CY 2004</u>	<u>CY 2005</u>	<u>CY 2006</u>	<u>CY 2007</u>	<u>CY 2008 est.*</u>
Departmentwide					
CO- I Tested	3,054	3,036	5,757	5,297	6,908
CO- I Interviewed	2,129	2,568	3,807	3,577	3,974
Division of Correction					
CO-I Hired	576	724	914	745	792

* Calendar 2008 estimates based on year-to-date figures and monthly averages through September 2008.

Source: StateStat Department of Public Safety and Correctional Services Personnel Summary

Additional recruitment and retention efforts undertaken by DPSCS include:

- reaching out to military bases to hold career fairs and to candidates who applied but were not selected for Department of Natural Resources police positions;
- increasing monthly advertising expenditures dedicated to recruitment purposes and creating a recruitment video for Internet use; and
- implementing an extended field training officer program, which increases employee-trainee mentorship by three weeks, in order to help new hires better acclimate to working in the prison environment.

Public Safety

Medevac

In the aftermath of a legislative audit citing maintenance issues, and a recent fatal helicopter crash, unanswered questions remain as to how best to continue the State's Medevac program.

Background

Since 1970, the Maryland Department of State Police (DSP) has operated a system of aircraft to provide emergency medical evacuation (Medevac) services and other flight services to the State's citizens. The Maryland State Police Aviation Command (MSPAC) operates a fleet of 12 helicopters and two fixed wing aircraft at eight operating bases throughout the State. MSPAC's mission has evolved to include medical evacuations, search and rescue, law enforcement, and most recently, homeland security.

The existing fleet of helicopters was purchased over an 11-year period beginning in 1989. Since that time, a number of studies have been conducted to evaluate the life expectancy of the aircraft, including the cost, timing, and financing for replacing the fleet. Most recently, a 2006 study conducted by DSP recommended that the State begin replacing the 12 twin-engine Eurocopter Dauphin helicopters beginning in fiscal 2009.

Financing State Police Medevac Helicopters

Interest in replacement of the aging fleet has prompted several legislative initiatives to designate funding for procurement.

Helicopter Replacement Fund

Chapter 416 of 2006 established a State Police Helicopter Replacement Fund (SPHRF). The fund receives a \$7.50 surcharge assessed for certain traffic convictions. Although fiscal estimates projected that approximately \$1.5 million would be credited into SPHRF annually, it was clear that this direct revenue and any accrued interest earnings would not approach the funding needed to finance procurement of the entire fleet over the short term. Approximately \$1.6 million has been credited to SPHRF since its inception.

Sales and Use Tax

Chapter 6 of the 2007 special session provided that a portion (\$110 million) of the revenues from the increased sales and use tax in fiscal 2008 be directed to SPHRF. The law also expressed the intent of the General Assembly that the Governor include sufficient expenditures from the fund to purchase three helicopters per year from fiscal 2009 to 2012. However, the Spending Mandate and Revenue Dedication Relief Act of 2008 (Chapter 414 of 2008) modified Chapter 6 to dedicate \$50 million, rather than \$110 million, to SPHRF. To replace this funding, Chapter 414 also required the Governor to include a total of \$70 million for the purchase of Medevac helicopters in the fiscal 2010, 2011, and 2012 State budgets. These funds could be from any budgetary fund that receives sales and use tax revenues. Appropriations could also be reduced by the amount of capital debt that may be authorized for helicopters or by any contribution, transfer, or financing acquired from the Maryland Automobile Insurance Fund as authorized by an act of the General Assembly.

Pay-as-you-go (PAYGO) Funding

The fiscal 2009 operating budget included \$33.6 million in PAYGO special funds to procure the first installment of three Medevac helicopters. Although a Request for Information was issued in April 2008, no Request for Proposal has been issued to date. According to the most recent helicopter procurement timeline provided by DSP, the department anticipates that the first installment of helicopters will be ordered in fiscal 2010 for delivery in fiscal 2011.

Recent Developments

Recent developments have prompted numerous legislative inquiries regarding the status of Maryland's Medevac fleet.

Performance Audit

An August 2008 performance audit conducted by the Office of Legislative Audits (OLA) disclosed a number of issues pertaining to the efficiency and effectiveness of MSPAC's operations. Particularly, OLA noted that DSP's ability to make informed decisions about Medevac availability and maintenance was severely hampered by the lack of reliable and comprehensive data systems needed to manage, track, and assess critical aspects of its operations. The audit also highlighted MSPAC's impeccable safety record, having flown almost 90,000 flight hours without a major accident, injury, or fatality.

Medevac Crash

About one month following the audit's release, a fatal Medevac helicopter crash occurred in Prince George's County, killing four of the five people on board. The helicopter (Trooper 2),

which was stationed at Andrews Air Force Base, was responding to the scene of a traffic accident. Air safety investigators with the National Transportation Safety Board (NTSB) are examining whether mechanical failure, navigational problems, or pilot error contributed to the crash. Many of the Medevac helicopters remain grounded as NTSB continues its investigation. NTSB has issued a preliminary report that includes an events timeline and will issue a final report upon completion of the full investigation.

New Medevac Transportation Protocols

Following the fatal helicopter crash, amidst allegations of possible Medevac over usage, new protocols were implemented to determine whether an injured patient is airlifted to a trauma center. Under the new guidelines, Medevac requests for trauma patients with seemingly noncritical injuries now require a medical consultation with a trauma center prior to dispatching a helicopter. Previously, that decision was made by paramedics without doctor input. Maryland's Institute for Emergency Medical Services Systems is expected to convene a helicopter panel in November 2008 to evaluate the recent changes to the State's Medevac protocols. According to reports, the panel is expected to issue its findings and recommendations by December 2008.

Conclusion

In the wake of the fatal helicopter crash, MSPAC's performance audit, and recent changes to Medevac transportation protocols, many questions remain unanswered regarding the current state of Maryland's Medevac fleet. It is likely that the General Assembly will address a multitude of Medevac issues during the 2009 legislative session, including the findings and recommendations of the helicopter panel; allegations of possible Medevac over usage; the fiscal impact of the revised protocols on the fleet's operating requirements and size; and the optimal financing mechanism for replacing the fleet.

Public Safety

Surveillance by State Police

Surveillance and investigation by the Maryland State Police of nonviolent political and advocacy groups and individuals was recently revealed. A review conducted by former Attorney General Stephen Sachs detailed the actions taken and recommended that new procedures be adopted.

Background

In mid-July 2008, it became publicly known that the Maryland State Police (MSP) had engaged in covert surveillance of peaceful anti-death penalty and anti-war groups in 2005 and 2006. The surveillance was revealed when MSP released 43 pages of documents to the American Civil Liberties Union (ACLU) in response to a Public Information Act request. According to news reports, officers spent at least 288 hours spying on meetings and rallies between March 2005 and May 2006 and provided reports to databases accessible by local and federal law enforcement agencies. However, no indication of any intention to engage in criminal activity by the subjects of the surveillance was ever discovered.

Governor Martin O'Malley immediately denounced the surveillance activities, noting that it had occurred under the previous Administration, and vowed not to allow police to monitor people exercising their right to free speech when there is no evidence of wrongdoing. On July 31, 2008, the Governor appointed former Attorney General Stephen H. Sachs to conduct an independent review of the facts and circumstances surrounding the covert surveillance operation. Mr. Sachs completed his review and submitted his report on September 29, 2008.

Sachs Report

Findings

According to the Sachs report, the covert operation was launched in March 2005 for the purpose of gathering information relating to the upcoming executions of death row inmates Vernon Lee Evans, Jr. and Wesley Eugene Baker. Using false names and posing as sympathizers, the State troopers involved in the surveillance attended over two dozen protests and meetings of groups including the Baltimore Coalition Against the Death Penalty, the Baltimore Pledge of Resistance, and the Committee to Save Vernon Evans. The trooper leading the investigation, who was a member of MSP's Homeland Security and Intelligence Division (HSID), took significant steps to infiltrate the groups, including chatting online with group members via a covert email account, and attending numerous small planning meetings. The

trooper filed detailed written reports about what happened at each meeting and what was said by participants.

The lead trooper's reports revealed no evidence of proposed criminal conduct or unlawful activity of any kind. In fact, the trooper noted that the subjects clearly stated that they did not intend to violate the law during their planned protests. Nevertheless, the trooper repeatedly recommended that the investigation continue.

Information about the investigation was then entered into HSID's electronic database, "Case Explorer," and labels such as "Security Threat Group" and "Terrorism – Anti-War Protestor" were assigned to subjects of the surveillance. Information about these subjects – including, in some cases, the "terrorism" designation – was then transmitted to a database maintained by the Washington-Baltimore High Intensity Drug Trafficking Area (HIDTA) program, a federally funded initiative to promote cooperation and information-sharing among federal, state, and local law enforcement agencies.

Mr. Sachs found no evidence that MSP targeted the activists for monitoring because of any disagreement with, or desire to suppress, their political, ideological, or moral beliefs. He determined, rather, that MSP's principal purpose was to promote public safety by preparing for any civil disturbance that might occur in connection with the planned executions.

The Sachs report concluded that (1) the surveillance intruded upon the ability of law-abiding Marylanders to associate and express themselves freely; (2) MSP violated federal regulations when it transmitted some of its investigative findings to the HIDTA database, because there was no reasonable suspicion of involvement in criminal activity; and (3) MSP showed a lack of judgment in labeling as "terrorism" the peaceful activism that was the subject of its investigation.

Recommendations

To prevent this type of overreaching from happening in the future, the Sachs report recommended that MSP (1) adopt regulations forbidding covert surveillance of individuals or groups unless there is a prior written finding by the superintendent that the surveillance is justified because it is based on a reasonable, articulable suspicion of a present or planned violation of the law, and a less intrusive method of investigation is not likely to yield equivalent results; (2) establish standards for the collection, dissemination, auditing, and purging of criminal intelligence information; (3) revise, and possibly discontinue, its use of the Case Explorer database in connection with its intelligence-gathering activities; and (4) contact all individuals who are inaccurately described in the Case Explorer database as being suspected of involvement in "terrorism," allow those individuals an opportunity to review the relevant data entries, and then purge those entries.

Hearing in Judicial Proceedings Committee

At a hearing before the Senate Judicial Proceedings Committee on October 7, 2008, Thomas E. “Tim” Hutchins, Superintendent of State Police at the time of the surveillance, maintained that the surveillance was legal as well as necessary because the groups had a potential for violence. According to Superintendent Hutchins, Governor Robert L. Ehrlich, Jr. was not aware of the surveillance. The current superintendent, Colonel Terrance B. Sheridan, indicated acceptance of the Sachs report and stated that the investigation went on too long and was a waste of resources. Sheridan pledged that the practices in question would not continue and reported that he has instituted internal rules that clearly define how MSP will conduct criminal intelligence gathering. Sheridan further stated that MSP was in the process of mailing certified letters to the 53 individuals mistakenly identified as terrorists in the database so they can review their files and request that these files be purged from the system. (The mailings were completed shortly after the date of this hearing.)

Policy Implications

Subjects of the surveillance have expressed outrage, reporting feeling violated and fearing that the issue will cause members of the public to be reluctant to participate in their protest activities. They also fear that adverse actions might be taken against them personally or professionally because of the “terrorist” designations. Some of the subjects have written to Governor O’Malley requesting a more complete investigation. The ACLU and others have claimed that the scope of the surveillance by MSP was broader than was detailed in the Sachs report.

According to the ACLU, similar reports of inappropriate police surveillance have occurred in Colorado and California. ACLU officials have said that the case is reminiscent of the FBI’s infiltration of civil rights and anti-war groups in the 1970s. The ACLU does not believe that an agency such as MSP can be trusted to regulate itself on such matters.

This issue is likely to be debated into the 2009 session. Legislation is expected to be introduced to codify one or more of the Sachs recommendations and/or otherwise prohibit police overreaching.

Criminal Law

Death Penalty

The *de facto* moratorium on the imposition of the death penalty in Maryland continues, as regulations on lethal injection procedures have not yet been adopted. The U.S. Supreme Court has upheld the constitutionality of lethal injection as a method of execution. The Maryland Commission on Capital Punishment voted to recommend that the death penalty be repealed. The commission's final report is due by December 15, 2008.

Recent Court Decisions

Maryland Court of Appeals

Executions in the State have been halted since the December 2006 decision by the Maryland Court of Appeals in *Evans v. State*, 396 Md. 256 (2006). In that case, Vernon Evans, Jr., an African American who was sentenced to death in Baltimore County for the contract killing of two white people, claimed that his sentence was illegal because it was based on an unconstitutional race-based selective prosecution. Mr. Evans also sought an injunction against the use of the execution protocol of the Department of Public Safety and Correctional Services (DPSCS). The Court of Appeals, as it had done in an earlier case, rejected the race-based constitutional challenge. However, the court held that DPSCS execution protocols directing the administration of lethal injection are ineffective until either (1) the protocols are adopted as regulations according to the Administrative Procedure Act (APA); or (2) the General Assembly statutorily exempts the protocols from the requirements of the APA. In effect, the decision caused a moratorium on the imposition of the death penalty in Maryland until either DPSCS or the General Assembly acts. Although Governor Martin O'Malley directed DPSCS to begin developing regulations following the April 2008 Supreme Court decision upholding the constitutionality of lethal injection, to date, new regulations on lethal injection procedures have not been issued and legislation exempting the protocols from the APA has not passed.

Supreme Court

In April 2008 the Supreme Court ruled in *Baze v. Rees*, 553 U.S. ___, 128 S. Ct. 1520 (2008) that the lethal injection process used in Kentucky is a constitutional method of execution. The decision has wide ranging implications because the Kentucky procedures for lethal injection are substantially similar to the procedures used in many other states, including Maryland. In *Baze*, the court found that the procedures for administering the lethal three-drug combination do not result in a risk of substantial pain so great as to violate the Eighth Amendment's prohibition on cruel and unusual punishment. Chief Justice John G. Roberts, Jr. wrote for the majority that "[s]imply because an execution method may result in pain, either by accident or as an inescapable consequence of death, does not establish the sort of 'objectively intolerable risk of

harm’ that qualifies as cruel and unusual.” Under the decision, there must be a showing that there is an alternative procedure that is “feasible” and “readily implemented,” and that would “significantly reduce a substantial risk of severe pain” for a method of execution to be found unconstitutionally cruel and unusual. The usefulness of this standard, however, may be limited because although seven justices found the procedures constitutional, a majority could not agree on the standard for evaluating constitutionality. The decision may, therefore, result in further challenges to the administration of capital punishment in the United States.

The immediate effect of the ruling in *Baze* was to lift the *de facto* national moratorium on executions that had been in place since the court announced in September 2007 that it would consider the case. After a more than seven-month national hiatus on capital punishment, Georgia executed William Earl Lynd in early May 2008.

In June 2008, the Supreme Court struck down a Louisiana statute that authorized the death penalty for the rape of a child. In *Kennedy v. Louisiana*, 554 U.S. ___, 128 S. Ct. 2641 (2008), the court held that “a death sentence for one who raped but did not kill a child, and who did not intend to assist another in killing the child, is unconstitutional under the Eighth and Fourteenth Amendments.” The court rested its holding on findings that there is no national consensus favoring capital punishment for the rape of a child and that a crime against an individual that does not involve murder is not among the worst offenses for which death is reserved as a sentence.

In early October 2008, the court amended but let stand its decision in *Kennedy* after it was discovered that a recent federal law, a 2006 amendment to the Uniform Code of Military Justice, specifically made child rape committed by military personnel a capital crime. The court added a footnote to its decision acknowledging the law and stating that “the military penalty does not affect our reasoning or conclusions.”

Vernon Evans, Jr. also filed a civil rights claim in the U.S. District Court of Maryland arguing that the use of lethal injection violates the ban on cruel and unusual punishment in the Eighth Amendment to the U.S. Constitution. The basis of the argument is that the combination of chemicals is inhumane and the execution is performed by correctional officers who are not medically trained. Evans also argued that his veins are so badly damaged from years of drug abuse that the lethal injection could cause extreme pain without careful attention. The federal claim is still pending as the case was put on hold after the decision in *Evans* halted executions in the State.

Legislative Initiatives

Maryland Commission on Capital Punishment

Chapters 430 and 431 of 2008 established the Maryland Commission on Capital Punishment to study all aspects of capital punishment as currently and historically administered in the State. The Acts required the Governor to appoint members reflecting the broad diversity of views on capital punishment and the racial, ethnic, gender, and geographic diversity of the State. Governor Martin O'Malley announced the membership of the commission, and the appointment of former U.S. Attorney General Benjamin Civiletti as chair, at a July 10 press conference and organizational meeting.

The commission has held five public hearings and meetings and three additional meetings. The commission has heard testimony from judges, law professors, attorneys, and others with expertise in or experience with the death penalty. David Kaczynski, brother of Unabomber Ted Kaczynski testified in opposition to the death penalty during the first meeting. Members of the public were given an opportunity to present their views at the hearings as well. Major topics that were discussed included the costs associated with trying death penalty cases, the impact on the families of both the victims and the condemned, fundamental fairness concerns, and the risk of convicting the innocent. Testimony tended to favor repeal of the death penalty.

On November 12, 2008, the commission voted 13-7 to recommend abolishing capital punishment in Maryland. Among other things, the commission found that:

- Racial and geographic disparities exist in how the death penalty is applied.
- Death penalty cases are more costly than nondeath penalty cases and take a greater toll on the survivors of murder victims.
- There is no persuasive evidence that risk of execution is a deterrent to crime.
- The unavailability of DNA evidence in some cases opens the “real possibility” of wrongly executing an innocent person.

A final report and, if applicable, a minority report, on the commission's findings and recommendations is required to be submitted to the General Assembly by December 15, 2008.

Other Legislative Proposals

Several bills related to the death penalty were considered in 2008 but were not passed. Two bills would have repealed the death penalty and all related provisions. These bills would

have converted any current death sentence to a sentence of life in prison without the possibility of parole. Another bill would have added the first degree murder of a victim, juror, witness, or officer of the court to the list of aggravating factors to be considered for death penalty eligibility. Finally, a bill was introduced to exempt from the requirements of the APA the protocols of DPSCS governing the administration of the death penalty, including any execution operations manual. As a practical matter, this bill would have ended Maryland's moratorium on the death penalty.

Criminal Law

Drug Sentencing Reform

<p>Maryland, like many states and the federal government, maintains a strict set of mandatory minimum penalties for repeat drug offenses. That approach has lately been questioned nationally, and by various legislative proposals in Maryland.</p>

Maryland Law

Since 1982, Maryland law has mandated a minimum 10-year nonsuspendable, nonparolable sentence for offenders convicted a second time of distributing, manufacturing, possessing with intent to distribute, or dispensing Schedule I or Schedule II narcotics or hallucinogens. Legislation enacted in 1988 established a 25-year mandatory minimum sentence for third-time offenders and a 40-year mandatory minimum sentence for fourth-time offenders. Potentially significant fines may also be imposed. A repeat offender is subject to a 2-year mandatory minimum sentence for distributing a drug that is not a narcotic or hallucinogen. Other mandatory minimum sentences apply to volume dealers, drug kingpins, offenders who possess or use a firearm while engaging in drug trafficking, and repeat offenders who distribute drugs near a school.

The New Movement – Treatment, Not Incarceration

According to a 2008 report by the Pew Charitable Trust's Public Safety Performance Project, more than 1 in every 100 adults in America are now confined in a local, state, or federal jail or prison. The Pew study noted that in Maryland, 23,342 people were behind bars in 2007, representing a 1.7 percent increase over the previous year. In fiscal 2007, the State spent \$1.084 billion on corrections; and for every dollar the State spent on higher education, 74 cents was spent on corrections.

In 2003, a commission convened by the American Bar Association called on Congress to repeal mandatory minimum sentences, and in 2006, the U.S. Conference of Mayors passed a resolution opposing mandatory minimum sentences for drug crimes. At least 18 states (not including Maryland) have now rolled back mandatory minimums or restructured penalties for drug offenses.

Advocates for repealing mandatory minimum sentences argue that locking up nonviolent drug offenders instead of treating their addictions does not cause permanent behavioral changes or improve community safety, prevents judges from addressing individual cases, and unfairly punishes low-level dealers who get the same amount of time in jail as major distributors. In

addition, it is argued that incarceration is significantly more expensive than drug treatment and is, therefore, not cost effective.

Taking another popular approach, in 2004 the General Assembly passed Senate Bill 194/House Bill 295 (Chapters 237 and 238), Administration measures designed to redirect substance abusers from prison and into treatment. Among other things, the legislation encouraged prosecutors to divert defendants to treatment by creating a system of case dismissals and suspensions with treatment conditions, streamlined the process through which substance-addicted defendants are committed to the Department of Health and Mental Hygiene for treatment, and required counties to establish local alcohol and drug abuse councils to coordinate identification of treatment needs and delivery of services.

Since the enactment of Chapters 237 and 238, the State's fiscal crisis has prevented growth in treatment spending. Judges are frustrated by a lack of residential treatment alternatives that limits the use of court-ordered commitments. Through efforts made in 2006 and 2008, statewide residential slots available for court commitment have increased from 160 beds to 190 beds. In recent years, however, there have been various times when the Alcohol and Drug Abuse Administration has been found in contempt of court for not being able to facilitate the statutorily required "prompt treatment of a defendant," which the courts have generally considered to be a wait time of 90 days from clearance to admission.

Recent Legislative Action

Various bills have been introduced in recent years to modify or eliminate mandatory minimum sentencing for repeat drug offenders. Most recently, in 2007, House Bill 992 passed the General Assembly but was vetoed by the Governor on policy grounds. The bill would have repealed the prohibition against parole applicable to the 10-year mandatory minimum sentence for a second conviction of drug distribution, if the person was not convicted of a crime of violence arising out of the incident that resulted in the mandatory minimum sentence. Under the bill, a defendant would be eligible for parole after serving two and a half years. The bill was a top priority of the Legislative Black Caucus, due to concern that African Americans make up a majority of defendants jailed on drug charges and was aimed at low-level nonviolent addicts who sell drugs to support their habits. The reasons cited by the Governor for vetoing the bill included that (1) despite the bill's applicability to nonviolent criminals, drug dealers participate in activities that fuel violent crime and murder; (2) Maryland law already allows two-time offenders opportunities to receive drug treatment services in lieu of mandatory sentences; and (3) the bill seeks to aid addicted individuals but does not require individuals to receive drug treatment services or make progress in addressing the public health and public safety issue of drug addiction.

In 2008, House Bill 845, a multifaceted bill altering penalties for certain drug offenses, was reported out of the House Judiciary Committee but re-referred to committee after heated floor debate. Specifically, it would have (1) reduced the penalties for possession of an amount of a controlled substance equal to or less than one-tenth of a gram; (2) eliminated the crime of

“manufacture of a controlled dangerous substance” from the current felony prohibition against the manufacture, distribution, or possession with intent to distribute and added it to the felony prohibition against manufacture, distribution, or possession of equipment used to produce a controlled dangerous substance; (3) established a new misdemeanor “criminal sale” penalty if the violation involved an amount of the particular controlled dangerous substance equal to or less than a specified amount, under limited circumstances; and (4) expanded eligibility for court-ordered drug treatment to certain repeat offenders and others who are currently ineligible.

Criminal Law

Task Force to Combat Driving Under the Influence of Drugs and Alcohol

The Task Force to Combat Driving Under the Influence of Drugs and Alcohol has reported its comprehensive plan, including recommendations for legislation, to reduce the incidence of driving under the influence of drugs and alcohol in Maryland. The centerpiece would be creation of a Maryland Alcohol Safety Action program to track offenses from arrest through adjudication and treatment and analyze results.

Background

Chapters 533 and 534 of 2007 established the Task Force to Combat Driving Under the Influence of Drugs and Alcohol to study driving under the influence of drugs and alcohol (DUI) and recommend to the Governor and the General Assembly:

- actions necessary to implement national best practices for combating DUI offenses;
- new State initiatives to address all impaired driving populations;
- actions to sustain and enhance the public's awareness and concern for the danger posed by drunk driving; and
- strategies for improved coordination of management, funding, and resources at State and local levels.

Findings and Recommendations

The task force submitted its final report in October 2008. The task force found that while Maryland has an array of laws, strategies, and programs to address the problem of DUI offenses, the number of impaired driving crashes and their associated injuries and fatalities changed little in recent years, and the average number of yearly fatalities has remained at about 220. The report also identified concerns with the handling of DUI offenses, including insufficient resources for enforcement and adjudication, inconsistency and inefficiency in the handling of these cases, and a confusing system of laws.

Maryland Alcohol Safety Action Program

The task force made 42 recommendations in its final report. The centerpiece recommendation is a multi-agency initiative that would establish a Maryland Alcohol Safety Action Program (MASAP) modeled after a program operated in Virginia since 1975. MASAP

would be an oversight agency for local, county-based Alcohol Safety Action Programs (ASAP). The ASAP model is a comprehensive coordinating and monitoring program that tracks DUI offenders from arrest through treatment and probation. The program includes the five target areas of enforcement, adjudication, case management and offender intervention, public information, and evaluation and certification. The purpose of the program is to increase the accountability of and services for DUI offenders and to create a consistent system for enforcement, adjudication, and intervention. The task force recommended that the model be introduced as a pilot program in two or three counties and administered by the Department of Health and Mental Hygiene.

Legislative Initiatives

Seven recommendations are legislative initiatives. One initiative, aimed at underage drinking, would (1) create a “no consumption” law for underage individuals in addition to the current prohibition on possession; (2) impose a six-month driver’s license suspension on an individual between 16 and 20 years old who illegally possesses or consumes alcohol, subject to an exemption for travel to work, school, or health care. (Representatives of the Maryland Trial Lawyers Association and the Office of Public Defender dissented from this recommendation citing lack of a nexus between a license suspension and possessing or consuming alcohol that is not related to driving.); and (3) make it a criminal, rather than civil, offense for an adult to obtain alcohol for, or provide alcohol to, anyone under the age of 21 years.

Other legislative initiatives include (1) making the violation of an alcohol restriction on a driver’s license an incarcerable offense; (2) increasing the amount of time, from 5 to 10 years, before a court could grant another probation before judgment; (3) making an offense for “driving while impaired” or a test refusal count for purposes of administrative sanctions for subsequent offenders; (4) requiring law enforcement officers to request alcohol testing of all drivers involved in life-threatening or fatal crashes, to be used exclusively for research purposes; (5) requiring minimum periods of 6 consecutive violation-free months (and 12 months for subsequent offenders) for ignition interlock users; and (6) recodifying all DUI-related traffic laws to eliminate duplication and make the laws easier to understand.

Other Initiatives

Other recommended initiatives involve conducting additional study, including the creation of a special committee that would meet regularly to discuss and evaluate the impact of the task force recommendations and related issues. Ignition interlock systems are the subject of other recommended initiatives, including evaluation of certain aspects of the Ignition Interlock Program and support for the increased use of ignition interlock systems for first-time offenders.

Finally, other recommendations involve increasing awareness and understanding of issues related to alcohol- and drug-impaired driving, including the provision of educational materials to judges, prosecutors, and defense attorneys, and development of research-based model curricula for elementary, middle, and high school classrooms.

Criminal Law

Speed Cameras

Legislation to expand automated enforcement of speeding laws from Montgomery County to other local jurisdictions and to highway work zones throughout the State will likely be introduced during the 2009 session.

Background

Speed monitoring systems, commonly referred to as “speed cameras,” are used to detect motor vehicles operating above the posted speed limit. A speed camera, which may be implemented as a fixed or mobile unit, contains a radar detector and a camera. A speeding vehicle triggers the camera and a photograph of the vehicle is taken. The photograph records the date, time, speed recorded, and registration plate of the vehicle. A citation for speeding is then sent to the registered owner of the vehicle.

In Maryland, the use of speed cameras is authorized in Montgomery County only. The cameras may be installed by the county or a municipal corporation in the county. The county or municipal corporation may only issue citations for a speeding violation based on a photographic image from a speed camera if the violator is traveling at least 10 miles per hour above the posted speed limit. Speed cameras may only be used on a highway in a residential district with a maximum speed limit of 35 miles per hour or in a school zone. The recorded image must include at least two time-stamped images of the vehicle next to a stationary object, show the rear of the motor vehicle, and clearly identify the registration plate number of the motor vehicle on at least one image or portion of tape. The maximum penalty for a violation recorded by a speed camera is a civil fine of \$40. Fines in uncontested cases are paid directly to the issuing political subdivision. An individual who wishes to contest a citation may elect a trial in the District Court. Fines in contested cases are paid to the District Court and remitted to the Comptroller.

According to news reports, in the first nine months of the Montgomery County program, the cameras recorded 178,000 speeding violations. The program, which was budgeted for \$3.3 million, earned \$5.2 million during this period. Montgomery County further estimates that the program will earn between \$10 and \$14 million in fiscal 2009. According to an independent study conducted by the Insurance Institute for Highway Safety, the number of drivers exceeding the speed limit by more than 10 miles per hour declined by 70 percent after the program began. The study was conducted over a one-year period, spanning the six months preceding and following the implementation of speed camera enforcement.

2008 Legislation

During the 2008 session, the General Assembly considered several bills related to speed cameras. In particular, conference committee reports on House Bill 364/Senate Bill 269 would have expanded the Montgomery County speed camera program statewide, with changes to program specifications. These changes included (1) raising the maximum speed limit for eligible residential roads to 45 miles per hour; (2) raising the speed tolerance to 12 miles per hour above the posted speed limit; (3) establishing a 30-day warning only period when a local jurisdiction first implements a speed camera program; (4) discouraging the placement of speed cameras near signs indicating a change in speed limit; (5) reverting unspent funds derived from speed camera fine revenue to the general fund of the State; (6) repealing the “tattletale” provision requiring a person who cites as a legal defense that the person was not driving the vehicle to provide the name and address of the actual driver; (7) clarifying the relationship between the authority of a county and a municipal corporation to use speed cameras; and (8) requiring better coordination in implementing a speed camera program between a local jurisdiction and the District Court.

A second part of the 2008 legislation would have established a statewide speed camera program for highway work zones. Under the program, specified State or local police departments would have been authorized to use speed cameras in properly identified highway work zones on an expressway or controlled access highway on which the speed limit is at least 45 miles per hour. The maximum penalty also would have been a civil fine of \$40, collected by the District Court and remitted to the State Comptroller. Of the amount remitted, the Comptroller would have been required to distribute to the State Highway Administration an amount to cover the cost of implementing and administering the program. The remaining revenue would have been distributed to the general fund of the State. Other program specifications would have been substantially similar to the specifications established under the proposed local program.

The General Assembly also considered local bills to establish speed camera programs in Baltimore County, Howard County, and Prince George’s County that would have been the same or similar to the Montgomery County program.

2009 Session

Both the Maryland Municipal League and the Maryland Association of Counties have identified this issue as a priority for local governments. Parts of the 2008 legislation, governing the use of speed cameras by local jurisdictions and in highway work zones, respectively, may also be considered. As in 2008, local delegations may also seek to authorize speed cameras in their jurisdictions.

Courts and Civil Proceedings

Judicial Compensation

<p>The General Assembly will consider joint resolutions containing salary increases of nearly \$40,000 over a four-year period for each judge at all judgeship levels, as recommended by the Judicial Compensation Commission.</p>

Background

The Judicial Compensation Commission, established in 1980, is charged with studying and making recommendations regarding all aspects of judicial compensation in order to ensure that highly qualified persons will be attracted to the bench and will continue to serve without undue economic hardship.

The commission consists of seven members, all appointed to six-year terms by the Governor. Five of the members are appointed from lists of nominees as follows: two from a list of at least five nominees submitted by the President of the Senate, two from a list of at least five nominees submitted by the Speaker of the House of Delegates, and one from a list of at least three nominees submitted by the Maryland State Bar Association. The Governor also appoints two members at large.

The commission is required to review judicial salaries and pensions and make recommendations to the Governor and the General Assembly once every four years. A joint resolution incorporating the salary recommendations must be introduced in each house of the General Assembly by the fifteenth day of the session following the commission's proposals. The General Assembly may amend the joint resolution to decrease, but not increase, any of the salary recommendations, and it may not reduce the salary of a judge below current levels. Failure by both houses of the General Assembly to adopt or amend a joint resolution within 50 calendar days after its introduction results in adoption of the salary recommendations. If the General Assembly rejects any of the commission's recommendations, the salaries of the judges remain unchanged, unless modified under other provisions of law.

In 2005, a four-year phased-in salary plan recommended by the commission was implemented after the General Assembly did not adopt or amend the joint resolution containing the salary plan within 50 days after its introduction.

Also in 2005, a provision that judges not receive a cost-of-living adjustment in any year in which they receive a salary increase recommended by the commission was enacted as part of the Budget Reconciliation and Financing Act (BRFA). The 2005 BRFA also limited the frequency of review of judicial compensation and recommendations by the commission by establishing a schedule of once every four years, instead of the prior requirements that the

commission review judicial compensation every two years and make recommendations at least every four years.

Recommendations for the 2009 Session

In August 2008, Elizabeth J. Buck was elected as the chair by the members of commission, which met two additional times to consider its recommendations. The Department of Legislative Services provided information on the State's economic condition as well as projections for future budget shortfalls. The commission also heard presentations from the Maryland Judiciary and the Maryland State Bar Association on judicial salaries, national and regional rankings, and obstacles to recruiting and retaining talented individuals on the bench.

In October 2008, the commission finalized its recommendations to increase the salaries of all Maryland judges by \$39,858 over a four-year period. Joint resolutions introduced in the 2009 session will propose the following annual salary increases for all judges at each of the current seven levels: (1) \$9,111 beginning July 1, 2009; (2) \$9,658 beginning July 1, 2010; (3) \$10,237 beginning July 1, 2011; and (4) \$10,852 beginning July 1, 2012. Those changes, as well as current salary levels, are presented in **Exhibit 1**, below:

Exhibit 1 Current and Proposed Judicial Salaries

<u>Position</u>	<u>Current Salary</u>	<u>Beginning 7/1/2009</u>	<u>Beginning 7/1/2010</u>	<u>Beginning 7/1/2011</u>	<u>Beginning 7/1/2012</u>	<u>Percent Change</u>
Court of Appeals						
Chief Judge	\$181,352	\$190,463	\$200,121	\$210,358	\$221,210	+ 22%
Associate Judge	\$162,352	\$171,463	\$181,121	\$191,358	\$202,210	+ 25%
Court of Special Appeals						
Chief Judge	\$152,552	\$161,663	\$171,321	\$181,558	\$192,410	+ 26%
Associate Judge	\$149,552	\$158,663	\$168,321	\$178,558	\$189,410	+ 27%
Circuit Court	\$140,352	\$149,463	\$159,121	\$169,358	\$180,210	+ 28%
District Court						
Chief Judge	\$149,552	\$158,663	\$168,321	\$178,558	\$189,410	+ 27%
Associate Judge	\$127,252	\$136,363	\$146,021	\$156,258	\$167,110	+ 31%

Source: Department of Legislative Services.

Courts and Civil Proceedings

Revision of Child Support Guidelines

Legislation may be introduced to revise the child support guidelines originally enacted in 1989 to reflect changes in child-rearing costs and income levels.

Background

In any proceeding to establish or modify child support, a court is required to use the statutory child support guidelines.

Three child support guideline models are generally used in the United States. Twelve states (Alaska, Arkansas, Georgia, Illinois, Massachusetts, Minnesota, Mississippi, Nevada, North Dakota, Tennessee, Texas, and Wisconsin) and the District of Columbia use the “Percentage of Obligor’s Income” model. Under this model, the child support level is set as a percentage of only the noncustodial parent’s income. Three states (Delaware, Hawaii, and Montana) use what is referred to as the “Melson Formula.” This model uses a proportion of income from both parents to establish financial support for the child but also provides for each parent’s minimal self-support needs and the child’s primary support needs and incorporates a standard-of-living adjustment. The premise of the “Income Shares” model used in 35 states, including Maryland, is that a child should receive the same proportion of parental income as would have been received if the parents lived together. The basic child support obligation is determined in accordance with a statutory schedule and then divided between the parents in proportion to the adjusted actual income of each parent.

Maryland’s current guidelines were originally enacted in 1989 in response to federal child support mandates. At least every four years, the Child Support Enforcement Administration (CSEA) of the Department of Human Resources is required to review the child support guidelines to ensure that the application of the guidelines results in the determination of appropriate child support award amounts and to report its findings and recommendations to the General Assembly.

Revisions Under Consideration

CSEA is reviewing recommendations from its Child Support Guidelines Advisory Committee. The most significant recommendations being considered include (1) revising the guidelines to reflect more recent estimates of child-rearing expenditures; (2) adjusting provisions

under the guidelines relating to “extraordinary medical expenses”; and (3) extending the guidelines to higher income levels. The advisory committee also has recommended including the impact of Maryland’s above-average housing costs for combined monthly incomes up to \$10,000 and applying a flat-rate increase to obligations on combined monthly incomes above \$10,000 that is based on the average increase for combined monthly incomes below \$10,000.

Child Rearing Costs

The current schedule is based on economic estimates of child-rearing expenditures as a proportion of household consumption developed in 1988 by Dr. Thomas Espenshade using national data on household expenditures from the 1972-73 *Consumer Expenditure Survey* conducted by the U. S. Bureau of Labor Statistics. A congressionally mandated federal study on child-rearing costs was conducted in 1990 by Dr. David Betson using data from 1980 to 1986. The revised schedule under consideration would use the Betson data updated to 2008 price levels.

Medical Expenses

After determining the basic child support obligation in accordance with the schedule, child care expenses and extraordinary medical expenses are added to the basic obligation and divided between the parents in proportion to their adjusted actual incomes. Under Maryland law, “extraordinary medical expenses” are defined as uninsured expenses over \$100 for a single illness or condition. The advisory committee recommended that the definition be revised to mean uninsured expenses over \$250 per year, regardless of the number of illnesses or conditions.

Income Ceiling

The current schedule uses the combined monthly adjusted actual incomes of both parents and the number of children for whom support is required to determine the basic child support obligation. However, the maximum combined monthly income subject to the schedule is \$10,000. For parental income above the \$10,000 ceiling, the Court of Appeals has stated that:

[T]he guidelines do establish a rebuttable presumption that the maximum support award under the schedule is the minimum which should be awarded in cases above the schedule. Beyond this the trial judge should examine the needs of the child in light of the parent’s resources and determine the amount of support necessary to ensure that the child’s standard of living does not suffer because of the parents’ separation. Further, the judge should give some consideration to the Income Shares method of apportioning the child support obligation. *Voishan v. Palma*, 327 Md. 318 (1992).

Since the adoption of the guidelines 19 years ago, it has become more common for combined monthly incomes to exceed \$10,000 and for more cases to fall outside of the guidelines. The advisory committee recommended increasing the combined monthly income ceiling to \$30,000.

Environment and Natural Resources

Chesapeake Bay Restoration

Although Chesapeake Bay restoration efforts began decades ago, the State is expected to fall short of its 2010 bay restoration goals. Recent initiatives to address nutrient and sediment pollution are being outpaced by growth and development. As a result, bay restoration will continue to garner attention during the 2009 session.

Background

In 1999, the U.S. Environmental Protection Agency (EPA) identified the Chesapeake Bay as an impaired water body. In 2000, the Chesapeake Bay partners (the bay states, the District of Columbia, the Chesapeake Bay Commission, and EPA) negotiated the Chesapeake 2000 Agreement (C2K), which specified restoration goals to improve the bay and remove it from the EPA's List of Impaired Waters. As part of C2K, specific pollution reduction goals have been allocated to the various bay states. Maryland's recent pollutant loads, as modeled by the EPA's Chesapeake Bay Program, and associated reduction goals are summarized in **Exhibit 1**.

Exhibit 1 Maryland's Pollutant Loads and Reduction Goals

<u>Pollutant</u>	<u>2005 Loads</u>	<u>2006 Loads</u>	<u>2007 Loads</u>	<u>2010 Goal</u>
Nitrogen (million lbs/yr)	56.19	53.65	53.20	37.25
Phosphorus (million lbs/yr)	3.80	3.75	3.76	2.92
Sediment (million tons/yr)	0.99	0.97	0.97	0.71

Source: U.S. Environmental Protection Agency's Chesapeake Bay Program

The largest source of Maryland's nutrient and sediment pollution is runoff from agricultural lands, followed by urban/suburban runoff and point sources. In August 2007, the Department of Natural Resources (DNR) released Maryland's Tributary Strategy, which outlines basin-specific nutrient and sediment control actions necessary to reduce pollution from every source. While numerous efforts to restore the bay's water quality are already underway, the State is expected to fall far short of achieving its 2010 bay restoration goals. In fact, due to population growth and related development, EPA's Chesapeake Bay Program reports that in some areas, conditions have deteriorated. And as water quality declines, so does suitable habitat for the bay's native fisheries.

Tracking Progress With BayStat

In February 2007, Governor Martin O'Malley established BayStat as an accountability process for measuring and evaluating State initiatives directed toward restoring the bay. Chapters 120 and 121 of 2008 (Senate Bill 213 and House Bill 369) codified the BayStat Program, which includes a subcabinet composed of relevant State entities. The subcabinet meets monthly to assess and evaluate progress towards the State's bay restoration goals.

Update on Efforts to Address Nonpoint Source Pollution

Chesapeake and Atlantic Coastal Bays 2010 Trust Fund

Chapter 6 of the 2007 special session (House Bill 5) established a Chesapeake Bay 2010 Trust Fund to be used to implement the State's Tributary Strategy. The fund is financed with a portion of existing revenues from the motor fuel tax and the sales and use tax on short-term vehicle rentals. Chapters 120 and 121 of 2008 established a framework for how the trust fund money must be spent by specifying that it be used for nonpoint source pollution control projects and by expanding it to apply to the Atlantic Coastal Bays. The Acts also established a Chesapeake and Atlantic Coastal Bays Nonpoint Source Fund, administered by the Maryland Department of the Environment (MDE), to provide financial assistance for the implementation of urban and suburban stormwater management practices and stream and wetland restoration.

While the fiscal 2009 and 2010 distributions from the trust fund have not been determined yet, funds are expected to be targeted to projects within five tributary basins: Lower Eastern Shore, Choptank, Upper Eastern Shore, Lower Western Shore, and Patuxent River. Within these basins, it is anticipated that funds will be used for local implementation grants through DNR, projects funded by the Chesapeake and Atlantic Coastal Bays Nonpoint Source Fund, and existing programs within the Maryland Department of Agriculture (MDA) (such as the Cover Crop Program and the Maryland Agricultural Water Quality Cost Share Program).

The Governor's proposed fiscal 2009 budget included \$50 million from the motor fuel tax and sales and use tax on short-term vehicle rentals for the trust fund, but budget reconciliation legislation reduced this amount. As enacted, the fiscal 2009 budget includes \$25 million for the trust fund. However, the current revenue projections for the motor fuel tax and sales and use tax on short-term vehicle rentals are lower than the appropriation amount; the Department of Legislative Services currently estimates revenues of \$17.8 million for the trust fund in fiscal 2009.

Recent Regulatory Actions – Agricultural and Stormwater Runoff

In an effort to reduce nutrient pollution resulting from the storage of excess poultry litter, MDE recently proposed regulations to require a discharge permit for large poultry operations. According to MDE, the proposed regulations cover at least 200 poultry operations and bring over

50 percent of the State's poultry litter under MDE regulation. The proposed regulations are anticipated to take effect in early 2009.

MDE also recently proposed regulations to implement the Stormwater Management Act of 2007 (Chapters 121 and 122). The proposed regulations require the use of "environmental site design" to the maximum extent practicable in stormwater management practices. "Environmental site design" means using small-scale stormwater management practices, nonstructural techniques, and better site planning to mimic natural hydrologic runoff characteristics and minimize the impact of land development on water resources. These proposed regulations are also anticipated to take effect in early 2009.

Update on Efforts to Address Point Source Pollution

Bay Restoration Fund

The Bay Restoration Fund was created in 2004 (Chapter 428) to provide grants for Enhanced Nutrient Removal (ENR) upgrades at the State's 66 major wastewater treatment plants (WWTPs). ENR grants are the fund's primary expenditure, but funds are also dedicated to sewer infrastructure grants (through 2009 only), septic system upgrade grants, and MDA's Cover Crop Program. The fund is financed by a bay restoration fee on users of WWTPs and septic systems. Since 2004, MDE has used the fund to upgrade 12 percent of the State's 66 major WWTPs with ENR technology and to upgrade 377 septic systems with the best available technology for nitrogen removal.

While the estimated capital costs of upgrading all 66 major WWTPs to ENR were originally \$750 million, current estimates suggest that costs will exceed \$1.1 billion. However, current projections by MDE anticipate only \$868 million in bay restoration fee revenue. This will result in an estimated \$245 million shortfall which will need to be addressed at some point over the next few years. Possible solutions include (1) re-prioritizing, delaying, or canceling certain projects, (2) decreasing the percentage of total project costs eligible for grant awards, or (3) increasing the bay restoration fee.

Implications for the 2009 Session

As the population in the bay watershed continues to grow, the problems currently facing the bay will only intensify in the years to come. Accordingly, bay restoration will continue to garner attention during the 2009 session. It is anticipated that legislation will be introduced to address the impact of growth on bay restoration; encourage forest conservation; require nitrogen removal technology for septic systems in the Critical Area; and improve the native oyster fishery through aquaculture or otherwise. In light of Maryland's gloomy fiscal outlook, ensuring adequate and continuous funding for bay restoration will continue to be a challenge.

Environment and Natural Resources

Energy and Climate Change Policy

Although Maryland has already taken numerous steps to address energy conservation, energy efficiency, and renewable energy, legislation establishing specific greenhouse gas emission reduction goals was introduced in 2007 and 2008 but was unsuccessful. In addition, in August 2008, the Maryland Commission on Climate Change issued its Climate Action Plan, which outlines several mitigation and adaptation strategies for the State. The commission's recommendations are likely to spur activity in 2009.

Background

According to the Intergovernmental Panel on Climate Change, there is now scientific evidence that the world's temperatures are climbing and that human activities are very likely contributing to the increase. Continued global warming is expected to affect sea levels and weather patterns, resulting in impacts on human health, the environment, and the economy. Despite this, the federal government has not taken significant action to address this issue. As a result, several states are moving ahead with their own efforts to reduce greenhouse gas (GHG) emissions.

As a coastal state with large areas of low-lying land, Maryland is particularly vulnerable to the impacts of climate change. In recent years, the General Assembly has taken numerous steps to encourage energy conservation, efficiency, and alternative energy sources; these actions have established Maryland among the leaders on state climate policy.

Recent Policy Highlights

In 2006, the General Assembly passed the Healthy Air Act (Chapters 23 and 301), requiring Maryland to join the Regional Greenhouse Gas Initiative (RGGI), a regional cap-and-trade system to reduce carbon dioxide (CO₂) emissions from specified electric generating units. If successful, RGGI will reduce utility-sector GHG emissions by 10 percent by 2018.

In 2007, the General Assembly passed the Clean Cars Act (Chapters 111 and 112), requiring the State to establish a Low Emission Vehicle (LEV) Program and authorizing the State to adopt the strictest automobile emission standards allowable under federal law, California's LEV standards. Although the GHG component of this program cannot take effect without federal approval, which has been denied and is now tied up in court, once fully implemented, the Act is expected to reduce GHG emissions along with other air pollutants.

In addition to those efforts, in 2007 Governor Martin O'Malley issued an executive order establishing the Maryland Commission on Climate Change to develop a plan of action to address climate change and to prepare for the likely consequences and impacts of climate change. In January 2008, the commission released an interim report. The combined recommendations of this interim report and those made by the Maryland Energy Administration (MEA) in its Strategic Electricity Plan formed the basis for a range of energy-related legislation introduced during the 2008 session. The legislation that was passed during the 2008 session:

- addressed energy efficiency by codifying the EmPOWER Maryland initiative to reduce electricity consumption 15 percent below 2007 levels by 2015 (Chapter 131), requiring utilities to educate customers on the costs and benefits of its energy efficiency programs (Chapter 129), and requiring the implementation of “smart” electric meters if deemed cost-effective after further study by the Public Service Commission (Chapter 131);
- required certain State government buildings and new schools to be constructed in accordance with high performance green building standards (Chapter 124);
- encouraged additional clean energy generation in Maryland by modifying the Renewable Portfolio Standard to increase the percentage of electricity required to come from renewable energy sources (Chapter 126 of 2008), and by increasing the cap on grants for investments in solar and geothermal energy (Chapter 132 of 2008);
- established the Maryland Clean Energy Center as a technology incubator and source for industry-wide collaboration (Chapter 137); and
- created the Strategic Energy Investment Fund within MEA to allocate revenue from the auction of CO₂ allowances under RGGI for consumer benefit and strategic energy purposes (Chapters 127 and 128).

In its interim report, the commission also recommended the enactment of legislation requiring the State to develop and implement programs to reduce GHG emissions by 25 percent by 2020 and by 90 percent by 2050 (from 2006 levels). Although legislation was introduced during both the 2007 and 2008 sessions (Senate Bill 409/House Bill 890 of 2007 and Senate Bill 309/House Bill 712 of 2008) to require reductions in GHG emissions, that legislation was not successful.

Update on RGGI Implementation

Under RGGI, each participating state is allocated a certain number of CO₂ allowances (permits to emit one ton of CO₂) that serve as the state's respective share of a regional “cap” on CO₂ emissions. The cap will stabilize emissions through 2014 and will then be reduced by

10 percent from 2015 through 2018. The majority of CO₂ allowances are being distributed through regional auctions. The first auction was held on September 25, 2008. Maryland offered approximately 5.3 million of its total annual budget of 37.5 million allowances for sale. The allowances were sold at a price of \$3.07 per allowance, generating \$16.4 million in revenue. A second auction is scheduled for December 17, 2008, and others will follow quarterly.

Pursuant to Chapters 127 and 128 of 2008, revenue from the RGGI auctions is deposited into the Strategic Energy Investment Fund and used for specified purposes including energy efficiency and conservation programs, electricity rate relief for residential customers, electricity assistance programs, and clean energy programs. MEA is required to develop an expenditure plan for the fund for fiscal 2009 and 2010 by December 15, 2008.

Additional Legislative Activity Expected in the 2009 Session

Given the ongoing concerns about energy and climate change, it is likely that this issue will continue to spur legislative activity in the 2009 session. In August 2008 the Maryland Commission on Climate Change issued its Climate Action Plan, which includes a comprehensive assessment of climate change impacts in Maryland and a review and assessment of the costs of inaction. Most notably, however, the plan recommends the adoption of goals to reduce GHG emissions by 10 percent by 2012; 15 percent by 2015; 25 to 50 percent by 2020; and 90 percent by 2050 (from 2006 levels). The plan includes a suite of 42 mitigation strategies to meet those goals; according to the commission, adoption of those strategies will achieve an approximate reduction in GHG emissions of 40 to 55 percent from 2006 levels by 2020. Finally, the plan includes a comprehensive strategy for reducing Maryland's vulnerability to climate change.

A number of the policy options included in the Climate Action Plan could prompt the introduction of legislation in the 2009 session. In particular, it is expected that legislation establishing specific GHG reduction goals, as was proposed in the previous two legislative sessions, will be reintroduced in some form.

Environment and Natural Resources

Growth Management

Maryland's incentive-based approach to growth management has not demonstrably altered where and how growth occurs. To address this shortcoming, numerous recommendations are being considered that may help the State manage growth more effectively; these recommendations will likely garner attention during the 2009 session.

Background

Managing growth is one of the most significant environmental policy challenges currently facing the State. Maryland is the fifth most densely populated State in the nation, and it could add as much as 1.4 million people between 2000 and 2030, a 27 percent population increase. The U.S. Environmental Protection Agency recently reported that development growth is outpacing progress in watershed efforts to restore the Chesapeake Bay.

While significant zoning and planning authority is given to local governments, the State plays a role in managing growth through the Maryland Economic Growth, Resource Protection, and Planning Act of 1992 (Planning Act), and the Smart Growth and Neighborhood Conservation Act of 1997 (Priority Funding Areas Act). The Planning Act is organized around eight statutory vision statements which must be pursued in local comprehensive plans, where priorities for land use, economic growth, and resource protection are established. The Priority Funding Areas Act directs State spending to specified Priority Funding Areas (PFAs), in hopes of making the most efficient and effective use of existing infrastructure; supporting existing neighborhoods; and preserving Maryland's fields, farms, and open spaces.

Smart Growth Status

Maryland has received national attention over the past 10 years for its incentive-based approaches to managing growth. While Maryland's Smart Growth efforts have served as a model for many other states, the success of the program is not clearly undemonstrated. While about three-fourths of all building permits for new homes are issued for development inside PFAs, three-fourths of the land developed for new homes is outside PFAs. Maryland still lacks a State Development Plan and an associated system for measuring or monitoring progress toward specific goals. Also, it is difficult to determine whether a significant portion of State funding is being targeted in PFAs, as State agency reporting is limited. Finally, inadequate State and local government coordination and inconsistent Smart Growth and environmental policies are fueling growth management policy tension.

Policy Recommendations

Recommendations stemming from two recent initiatives are likely to prompt legislation relating to growth management during the 2009 session.

Task Force on the Future for Growth and Development in Maryland

The Task Force on the Future for Growth and Development in Maryland (established by Chapter 381 of 2006 and modified by Chapter 626 of 2007) is charged with studying a wide range of Smart Growth and land use issues impacting Maryland and reporting its findings and recommendations to the General Assembly and the Governor by December 1, 2008. The task force's draft legislative recommendations as of November 9, 2008, include:

Smart Growth

- address nitrogen removal from septic systems;
- provide additional funding for land preservation, transit-orientated development, local government infrastructure financing, local comprehensive plan development, and hydrologic studies and water monitoring; and
- reauthorize the Maryland Heritage Structure Rehabilitation Tax Credit Program and remove program funding caps.

Changes to State Planning Law

- amend Article 66B to remove any ambiguity and make it clear that a local jurisdiction must implement and follow the comprehensive plan it adopts;
- amend Article 66B to require reports on the impacts of Adequate Public Facility Ordinances;
- amend Article 66B to authorize local governments to establish a transfer of development rights program to facilitate the purchase of land for a school or other public facility within a PFA;
- update the eight visions set forth in the 1992 Planning Act; and
- re-establish a broad-based, statewide planning board or commission.

In addition to those draft legislative recommendations, the task force has also developed draft recommendations for actions to be implemented administratively. Among those recommendations is a consideration for natural resources when planning for growth, especially where water availability is a concern. In some parts of Maryland, a lack of water resources is dictating where new growth occurs. For example, in some parts of Carroll and Frederick counties, construction has been halted due to concerns about available water supplies.

Advisory Committee on the Management and Protection of the State's Water Resources

The Advisory Committee on the Management and Protection of the State's Water Resources (established by Executive Order 01.01.2005.25) was charged with assessing the State's water resources management program and recommending steps to assure that the program will provide for the long-term use, protection, and sustainable management of Maryland's water resources. Although the committee was not established solely as a result of growth-related water supply concerns, the committee's July 2008 final report concludes that because Maryland's population continues to grow, water resources management must be integrated with growth management and land use policy. The committee's final report included several proposals to ensure a sustainable water supply for Maryland's future. Examples include:

- develop and fund a more robust, comprehensive, fully integrated State water resources management program and provide adequate and reliable funding for the Maryland Department of the Environment's (MDE) Water Supply Management Program;
- promote collaborative local planning and facilitate regional planning;
- codify MDE's water allocation policies and require local jurisdictions to protect source waters; and
- strengthen State and local programs for water conservation, reuse, and demand management.

Possible Departmental Policy Actions

The Maryland Department of Planning (MDP) may address the following policy issues in the short term:

- Creation of a State Development Plan – MDP recently released a draft document that sets forth potential parameters for a State Development Plan, as recommended by the Task Force on the Future for Growth and Development in Maryland. In January 2009, MDP plans to initiate a six-month public comment period on this draft document.

- Maryland Heritage Structure Rehabilitation Tax Credit – This program provides tax credits equal to 20 percent of the qualified capital costs expended in the rehabilitation of a certified residential or commercial heritage structure. Certified structures must meet specified requirements; and the program is subject to an annual appropriation. The program is currently authorized through fiscal 2010. MDP is likely to offer legislation reauthorizing this program and making awards more predictable.
- Response to Decision in *Trail, et al. v. Terrapin Run, LLC, et al.* – The majority opinion in this recent Court of Appeals case could be interpreted to mean that local land use ordinances and regulations need not be consistent with the local comprehensive plan. MDP is likely to offer legislation that clarifies any ambiguity that may exist regarding the role that comprehensive plans play in State land use laws.

State Government

Election Administration

State and local election officials work to address past deficiencies and to improve and refine the election process in Maryland, but further challenges loom as the State moves forward to change over from an electronic voting system to a “voter-verifiable paper record” based system.

Continuing Challenges of Election Administration

Since the September 2006 gubernatorial primary, State and local election officials have worked diligently to address and correct election day problems involving voting equipment and staffing that were experienced during that election. Many of these problems were addressed and largely corrected before the November 2006 gubernatorial general election. The Attorney General’s Task Force on Voting Irregularities, formed to examine the problems of the 2006 elections and to recommend changes to address them, stated in its April 2008 report that the 2006 primary identified and highlighted a number of systemic problems in Maryland’s election structure. According to the task force, some of the problems, while temporarily overcome in the 2006 general election, continued to present a challenge for future elections. The task force offered short-term recommendations in its first report and indicated that a second report recommending long-term solutions would be issued later in 2008.

Anticipating a high voter turnout heading into the 2008 presidential general election, State and local election officials took additional actions to prepare for the election, including:

- acquiring additional voting machines and e-pollbooks;
- recruiting additional election judges and retraining of returning judges;
- developing plans for the deployment of spare voting machines in the event of voting lines;
- using a call center to help field voter inquiries; and
- enhancing voter outreach to encourage voting during the less-busy hours between 10 a.m. and 4 p.m.

The State Administrator of Elections indicated in September 2008 that voting lines were expected for the November 4 presidential general election, but with good preparations it was hoped that the lines would be manageable, a prognosis that proved to be generally accurate.

Procurement of a New Voting System

Chapters 547 and 548 of 2007, enacted following continued scrutiny in Maryland and nationwide of the security and accuracy of direct-recording electronic (DRE) touchscreen voting machines, provide in part that the State Board of Elections (SBE) may not certify a voting system unless it determines the voting system will provide a “voter-verifiable paper record.” The law is applicable to each election occurring on or after January 1, 2010.

The State’s existing DRE touchscreen voting machines do not produce a paper record that a voter may verify at the time of voting, and Chapters 547 and 548 specify that a voter-verifiable paper record, among other criteria, must be an individual document physically separated from any other document and not part of a continuous roll. This requirement strongly suggests the use of an optical scan voting system. Optical scan systems utilize individual paper ballots that are scanned into optical scan voting machines that tabulate the voters’ choices.

SBE has noted a potential problem, however, that could be encountered in procuring a voting system that would meet certain requirements of the 2007 legislation relating to the accessibility of the voting system for voters with disabilities. Under Chapters 547 and 548, a voting system selected, certified, and implemented must, among other things, provide access to voters with disabilities equivalent to that afforded to voters without disabilities, without creating a segregated ballot. The voting system also must comply with the accessibility standards of the Voluntary Voting System Guidelines (VVSG) developed in accordance with the federal Help America Vote Act (HAVA).

The U.S. Election Assistance Commission (EAC), created under HAVA, adopted the VVSG, which became effective December 2007, and administers a voting system testing and certification program in which independent laboratories are accredited by the EAC to test voting systems to determine compliance with the VVSG. SBE staff has indicated that certification under the EAC’s program would generally be the necessary litmus test to determine whether a voting system meets the requirement of Chapters 547 and 548 of 2007 that a voting system comply with the accessibility standards of the VVSG. However, to date, no voting system has been certified in accordance with the VVSG.

SBE plans to release the Request for Proposal for a new voting system in the fall of 2008 to gauge vendor response. However, it is possible that legislative changes will be necessary if there are no available voting systems that meet the accessibility requirements of the VVSG.

U.S. Supreme Court Voter ID Decision

During its 2007 term, the U.S. Supreme Court decided *Crawford v. Marion County Election Board*, in which the constitutionality of Indiana’s voter identification law, called the most stringent in the country, was challenged. The Indiana law requires persons voting in person to present federal or State government issued photo identification (with the exception of persons

that live and vote in a state licensed care facility) before voting. In a 6-3 decision, the Supreme Court upheld the law.

The petitioners in the case alleged, among other things, that the law substantially burdens the right to vote in violation of the Fourteenth Amendment. The State, on the other hand, had identified interests such as deterring and detecting voter fraud, election modernization, and safeguarding voter confidence as justifications for the voter ID law.

The lead opinion in the case generally found there to be insufficient evidence to support the petitioners' claim that the law imposed excessively burdensome requirements on any class of voters. The court instead concluded that when considering the statute's broad application to all Indiana voters it imposed only a limited burden on voters' rights, and the interests advanced by the state were sufficient to defeat the petitioners' challenge to the law's constitutionality.

According to *electionline.org*, a project of the Pew Center on the States, Indiana, Florida, and Georgia are the only states that require photo identification. Four other states, Hawaii, Louisiana, Michigan, and South Dakota, request photo identification, but voters without photo identification are allowed to sign an affidavit and vote a regular (nonprovisional) ballot. Eighteen additional states require identification from all voters, but both photo and nonphoto identification is accepted. Maryland is 1 of the 25 states that do not require photo identification from all voters.

State Government

Election Day Registration

As a growing number of legislatures across the country consider and authorize Election Day Registration (EDR), State officials have studied and issued a report on the potential implementation of EDR in Maryland. The Maryland Constitution would have to be amended before legislation authorizing EDR could become effective.

Background

Election Day Registration (EDR) permits eligible individuals to register and vote on election day. This reform is intended to boost participation in elections by giving people an opportunity to register or correct their current registration after the voter registration deadline. Expansion of EDR is being actively considered in state houses across the country and in the U.S. Congress. Nine states currently permit EDR. Wisconsin, Minnesota, and Maine implemented EDR in the 1970s. More recently, Montana implemented EDR beginning with the 2006 election, and Iowa and North Carolina began EDR for the 2008 election. Legislation to permit EDR has been introduced in many other states in recent years and has come close to enactment in several. Legislation requiring EDR for all federal elections was introduced in the 110th Congress. In Maryland, Chapter 61 of 2006 required the Office of the Attorney General and the State Administrator of Elections to study and report on issues related to the potential implementation of EDR.

EDR and Voter Turnout

States with EDR have significantly higher voter turnout than states that do not. According to data compiled by the advocacy group Demos, which supports EDR, average turnout in the states with EDR was 51 percent in the 2006 election, compared to 42 percent in the states without EDR. In the 2004 presidential election, 74 percent of voters turned out in EDR states, while 60 percent participated in non-EDR states, according to Demos. Some of the discrepancy in turnout between states with EDR and those without is attributable to other factors besides EDR. However, scholarly research supports the notion that EDR has a measurable effect on turnout. A study published in 2005 found that EDR increases turnout by 1 percent in presidential elections and more than 3 percent in midterm elections.¹ The 2006 report by the Maryland Attorney General and State Administrator of Elections found that EDR would likely increase turnout between 1 and 3 percent. EDR is particularly effective in boosting turnout of

¹ Mary Fitzgerald, *Greater Convenience But Not Greater Turnout: The Impact of Alternative Voting Methods on Electoral Participation in the United States*, 33 American Politics Research 842, 856 (2005).

young voters and voters who have recently moved, according to a study published in 2000.² Proponents of EDR also note that it permits unregistered individuals who become interested in an election late in the campaign to cast a ballot. EDR also gives voters whose registration is incorrect or who are mistakenly left off the rolls through no fault of their own an opportunity to re-register and vote on election day.

How EDR Works

All states with EDR require proof of identity and residency in order to register on election day. The type of documentation required to prove identity and residency varies in each state. Some states require photo ID and others do not. In Wisconsin, for example, a voter may show a state-issued driver's license or identification card, employer-issued identification card, property tax bill, residential lease, school identification card, utility bill, bank statement, paycheck, or other governmental document that includes a name and address. Several states allow an individual without the required documentation to register at the polling place if another registered voter vouches for the individual's identity and residence. In most EDR states, there are separate staffed tables in the polling place for people registering to vote and registered voters checking in to cast ballots. This is intended to ensure that new registrations do not delay voting. In EDR states, approximately 15 to 21 percent of voters register on election day.

Implementation of EDR in Maryland

The 2006 report by the Attorney General and State Administrator of Elections discussed several issues related to the implementation of EDR in Maryland. Several provisions of the Maryland Constitution must be amended before the General Assembly may pass legislation authorizing EDR. These provisions assume that registration is closed for a period of time before an election and on election day, and are, therefore, inconsistent with EDR, according to the report.

The report also indicated that local boards of elections would need two to three additional election judges in each precinct in order to handle EDR. Local governments would be responsible for the costs of the additional election judges. However, the number of provisional ballots issued would be greatly reduced with EDR. Voters not found on the list of registered voters and voters who must show ID because their registration is pending would be able to vote a regular ballot instead of a provisional ballot. This would save election officials time and effort in processing provisional ballots and could offset the cost of additional election judges.

² Stephen Knack and James White, *Election-Day Registration and Turnout Inequality*, 22 Political Behavior 29, 41 (2000).

EDR and Voter Fraud

A common concern raised about EDR is that it could make it easier to commit voter fraud, such as multiple voting. Elections officials in states with EDR report that incidents of fraud are very rare, according to the 2006 report of the Attorney General and State Administrator of Elections. For example, the New Hampshire Attorney General reported after making “a major effort” to investigate allegations of voter fraud in the 2004 general election that “there are very few instances of wrongful voting” in that EDR state. Some EDR states take additional measures to ensure security, such as mailing letters or postcards to EDR registrants after the election and investigating any cases where these are returned as undeliverable. However, the report of the Maryland Attorney General and State Administrator of Elections stated that the risk of fraudulent multiple voting could increase with the implementation of EDR unless the electronic pollbooks used to check in voters are able to communicate with other precincts in real time on election day.

Potential Legislation

House Bill 801, a bill to implement EDR, was introduced in the 2008 legislative session but was subsequently withdrawn from consideration before any action was taken. The sponsor indicated that the legislation would be reintroduced in the 2009 session together with a constitutional amendment authorizing the General Assembly to adopt EDR. If such an amendment were to pass the General Assembly, it would appear on the ballot for adoption or rejection by the voters in the 2010 statewide general election. Legislation implementing EDR could then take effect for all subsequent elections.

State Government

Early and Absentee Voting

Early voting continues to gain favor in states across the nation, as Maryland voters approved a constitutional amendment at the 2008 general election to authorize the General Assembly to craft legislation to implement early voting in the State. The constitutional amendment also explicitly authorizes the enactment of legislation providing for no-excuse absentee voting.

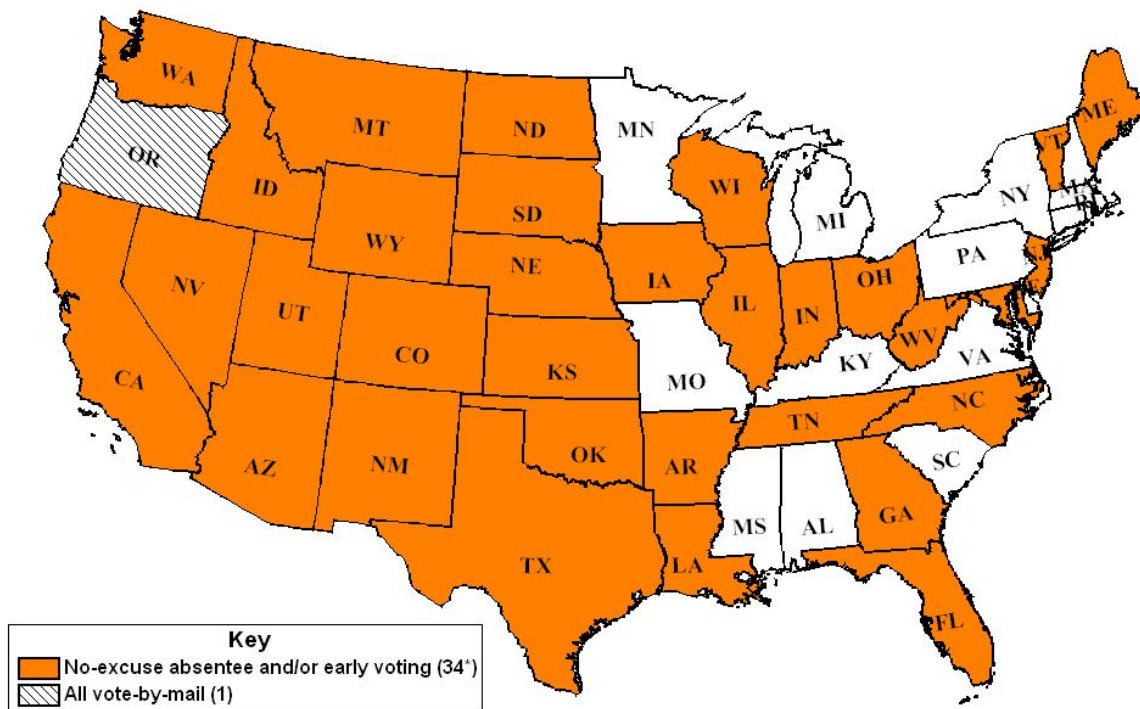
Background

Over the past several election cycles, the number of voters across the United States who cast their votes prior to election day has increased as states enact laws and implement policies that afford more opportunities for voters to do so. A 2008 general election preview report issued by *electionline.org* (a nonpartisan, nonadvocacy project of the Pew Center on the States) indicated that just prior to the 2008 general election, 33 states (see **Exhibit 1**) allowed no-excuse absentee voting by mail and/or no-excuse in-person early voting. In addition, Oregon has an all vote-by-mail system. The report quoted a consultant of the Pew Center on the States, who indicated that while more than 90 percent of ballots were cast at a polling place on election day a decade ago, nearly a third of voters was expected to cast in-person pre-election or absentee ballots during the 2008 general election.

The U.S. Election Assistance Commission recently completed a case study of early voting in Texas, which has had early voting for more than 20 years. According to the study, the Texas system began as no-excuse in-person absentee voting usually conducted at existing election offices; however, it since has evolved and been designated as “early voting” in state law, offering expanded availability (with multiple locations in the larger counties) and practices and procedures on par with those used on election day. In Texas, early voting now occurs between 4 and 17 days before election day, and registered voters may vote at any early voting location within their respective counties. Modems and other telecommunication devices are used to provide real-time connectivity to an elections office in order to prevent multiple voting.

According to the case study, early voting in Texas appears to serve only as an alternative voting method for active voters who otherwise would have voted on election day since overall turnout, as a percentage of registered voters, has not increased. Early voting has come with additional personnel and other expenditures; but, the study indicates, early voting has been embraced by the public and election officials (based, at least partially, on anecdotal evidence) because it enhances voter flexibility and decreases the likelihood of long lines and the resulting consequences of overcrowding at polling places on election day.

Exhibit 1 No-Excuse Absentee and/or Early Voting



*Maryland is included due to the availability of no-excuse absentee voting subsequent to the approval of the early/absentee voting constitutional amendment. Alaska and Hawaii, though not shown, also allow no-excuse absentee and/or early voting.

Source: Electionline.org, *Election Preview 2008* (October 2008); Department of Legislative Services

Early/Absentee Voting Constitutional Amendment

With voter approval of a constitutional amendment at the November 2008 general election, the Maryland Constitution will authorize (upon the issuance of the Governor's proclamation of the amendment's passage) the enactment of "a process to allow qualified voters to vote at polling places in or outside their election districts or wards or, during the two weeks immediately preceding an election, on no more than 10 other days prior to [election day]."

Chapter 513 of 2007, which proposed the now-approved constitutional amendment, also indicated that provisions of Chapters 5 and 61 of 2006 that provided for early voting, but were later invalidated by the Court of Appeals as unconstitutional, would not take effect and that the

applicable provisions of the Annotated Code of Maryland that codified the early voting law were repealed. Consequently, new legislation will be required to implement early voting in Maryland, which presumably will be introduced in the 2009 (or 2010) session.

Chapters 5 and 61 of 2006 would have, among other things, provided for a five-day early voting period prior to primary and general elections and allowed early voters to vote at any early voting polling place in the voter's county of residence. Three early voting polling places would have been established in the State's larger counties and one early voting polling place in each of the remaining counties.

In its December 2006 opinion invalidating early voting, the Court of Appeals also indicated that absentee voting provisions of the Maryland Constitution applied only to "absent" voters, and not to voters who merely find voting on election day to be inconvenient. Eligibility requirements for absentee voting in State law, however, had been repealed in the 2006 session. To clarify this matter, the approved constitutional amendment authorizes, in addition to the enactment of early voting legislation, the enactment of legislation providing for absentee voting by a qualified voter who chooses – for whatever reason – to vote absentee. With eligibility requirements for absentee voting having been repealed in 2006, the approval of the constitutional amendment allows for no-excuse absentee voting to be available going forward.

State Government

Base Realignment and Closure

Preparations are underway at both the State and local levels to accommodate the anticipated influx of over 27,000 new direct jobs through 2011, as a result of the 2005 Base Realignment and Closure (BRAC) plans. The Maryland Military Installation Council, the BRAC Subcabinet, and a Joint Legislative Committee on BRAC are overseeing and coordinating the various aspects involved with the transition.

2005 BRAC Impact on Maryland

In order to address an excess capacity of military facilities, the U.S. Congress created a process in 1990 known as Base Realignment and Closure (BRAC). The final plans regarding military installations nationwide became effective in November 2005.

The 2005 BRAC plans impact a number of the federal military installations in Maryland, resulting in an estimated 27,379 direct new jobs through 2011 and placing the State among the largest beneficiaries nationally. These changes at Fort Meade, National Naval Medical Center, Andrews Air Force Base, Aberdeen Proving Ground, and Fort Detrick are detailed in **Exhibit 1**. Thousands more indirect jobs are expected to be created through contractors and related services, for an estimated total of more than 45,000 federal and private-sector jobs. It is further estimated that Maryland will gain more than 28,000 households by the time the BRAC process is complete.

The Maryland Military Installation Council

Chapter 335 of 2003 created the Maryland Military Installation Strategic Planning Council, consisting of 19 representatives of State agencies and federal military installations, to serve as an advocate for military facilities located in Maryland and to coordinate State agency planning in response to changes caused by BRAC. After the approval of the 2005 BRAC plans, the State renamed the council the Maryland Military Installation Council (MMIC) and extended the termination date of the council through December 31, 2011 (Chapter 634 of 2006). The 2006 law also increased the membership of the council to 22 members by including representatives of local liaison organizations. MMIC is staffed by the Department of Business and Economic Development (DBED). At its meetings in 2008, MMIC kept abreast of regional base realignment and closure preparedness by hearing briefings from representatives of Maryland military installations, local governments, State agencies, the General Assembly, Congress, and private industry. MMIC's annual report is due by December 31 of each year.

Exhibit 1
Impact of BRAC on Maryland
Estimated Employment Gains in Direct Jobs through 2011

<u>Base</u>	<u>Estimated Employment Change</u>
Aberdeen Proving Ground (Harford County)	Gain of 8,779 jobs
Andrews Air Force Base (Prince George's County)	Gain of 3,000 jobs
Fort Meade (Anne Arundel County)	Gain of 11,800 jobs
Fort Detrick (Frederick)	Gain of 1,400 jobs
National Naval Medical Center (Bethesda)	Gain of 2,400 jobs
Total Job Growth	27,379

Source: Department of Business and Economic Development

BRAC Subcabinet

Chapter 6 of 2007 created a 10-member BRAC Subcabinet in State government chaired by the Lieutenant Governor. The subcabinet, composed of eight State secretaries of cabinet departments and the State Superintendent of Schools, is charged with a number of tasks, including:

- coordinating and overseeing the implementation of all State action to support the mission of military installations affected by BRAC;
- coordinating and overseeing the development of BRAC-related initiatives in various areas, including workforce readiness, education, business development, health care facilities and services, community infrastructure and growth, environmental stewardship, workforce housing, and transportation;
- working with local jurisdictions affected by BRAC to facilitate planning, coordination, and cooperation with the State;
- collaborating with and reviewing the recommendations of MMIC;
- working with Maryland's congressional delegation to obtain federal funds to support the missions of military installations in the State; and
- making policy and budget recommendations to strengthen State support of military installations in the State.

The subcabinet is required to submit an annual report and terminates December 31, 2011. The subcabinet is staffed primarily by DBED.

In December 2007, the subcabinet completed an action plan, in collaboration with local jurisdictions, to identify and guide critical tasks, programs, projects, activities, and initiatives that address the needs created by the arrival of residents and businesses. The subcabinet has begun to implement that plan and anticipates submitting a progress report in January 2009. The subcabinet also implemented a BRACStat program to compile and analyze statistics relating to BRAC.

Joint Legislative Committee on BRAC

Chapter 469 of 2007 established the Joint Committee on Base Realignment and Closure consisting of six members of the House of Delegates and six members of the Senate. Chapters 339 and 340 of 2008 added two delegates and two senators to the committee for a total membership of 16. The committee is required to provide continuing legislative oversight of the State's response to BRAC-related opportunities and changes. In cooperation with local and State units, it must also oversee and participate in developing systems and processes that fast track the approval of BRAC-related:

- transportation infrastructure;

- water and sewer infrastructure;
- State and local planning processes;
- affordable housing options;
- education facilities, including public school and community college construction; and
- health care facilities and infrastructure.

The committee held two meetings during the 2008 interim. The first took place at Cecil College in North East. Dr. Nancy Grasmick, State Superintendent of Schools, spoke about the Maryland State Department of Education's plans for BRAC accommodation. Panel discussions of local and regional representatives were also conducted on BRAC readiness associated with the Aberdeen Proving Ground region. At the second meeting, which was held at Fort Meade, State Transportation Secretary John Porcari briefed the committee on the Maryland Department of Transportation's (MDOT) plans for BRAC accommodation. A panel discussion of local and regional representatives on BRAC readiness associated with the Fort Meade region was also held.

2008 Legislation

BRAC Community Enhancement Act

Chapter 338 of 2008, an Administration measure, authorizes the Secretary of Business and Economic Development to designate BRAC Revitalization and Incentive Zones in the State. A local government may apply to have one of these BRAC Zones located within its jurisdiction. Among the factors to be considered by the Secretary in designating a BRAC Zone are the smart-growth and mixed-use characteristics of the area, the area's population density, whether the area is designated as an enterprise zone, the area's transportation options, and the overall State fiscal impact of the designation. Up to six BRAC Zones may be designated each year. The benefits of a BRAC Zone designation are primarily tax-related financial incentives.

Chapter 338 also authorizes a payment in lieu of taxes (PILOT) agreement for privately developed facilities in federal military reservations, also known as "federal enclave property." The Act establishes a negotiation process for State, local, federal, and private development interests to structure a PILOT agreement. Under federal law, in the absence of such an agreement, privately developed facilities in federal military reservations are subject to the full real property tax in effect in the local jurisdiction.

The Act also requires DBED to prepare a report, in consultation with the State Department of Assessments and Taxation, that outlines the enhanced use lease projects, or other private development projects, on federal enclave property; the extent these projects may be subject to State and local property taxes; and the status of PILOT agreement negotiations between local jurisdictions, the State, and private developers for projects on federal enclave property. The report must provide recommendations, if any, that would encourage PILOT

agreements for projects on federal enclave property. The report is due to the Governor and specified legislative committees by December 15, 2008.

The first applications to establish a BRAC Zone have been submitted. The BRAC subcabinet expects to announce acceptances on or about December 15, 2008.

BRAC Higher Education Fund

Chapter 341 of 2008 altered statutory provisions to allow money from the Higher Education Investment Fund to be used for higher education needs related to BRAC. The Maryland Higher Education Commission (MHEC) expects to dedicate \$10 million over three years for purposes including the expansion of campus capacity through the design and use of multimedia instruction and Internet-based course offerings, the enhancement of science-technology-engineering-math programs, expansion of adult learning initiatives, and the development of curricula and programs directly related to BRAC educational needs. MHEC has begun accepting grant proposals for this program from community, public, and independent colleges and universities in the State.

Preparations by State Agencies

Under the coordination of MMIC, State agencies are taking steps to prepare for a significant influx of military personnel, civilian employees, contractors, and families in the affected areas. The Maryland Department of the Environment is engaged in assessing adequacy of water and wastewater systems and securing funding for necessary upgrades. The Maryland Department of Planning has developed a strategy for accommodating and sustaining the incoming BRAC growth that is consistent with Smart Growth policies. The Maryland State Department of Education has put in place and begun to implement, as well as evaluate, a comprehensive plan to ensure that Maryland schools are ready for the children and families that will be part of BRAC. MDOT has assessed traffic and other transportation needs in the growth areas; held coordinating meetings with county planners, military alliances, and base personnel; and identified and begun work on specific BRAC-related traffic and transit projects. MHEC is working to expand higher education opportunities to better serve the BRAC mission. The Department of Labor, Licensing, and Regulation has been engaged in a number of activities to maximize the percentage of people who transfer to Maryland with their jobs and to ensure that once the jobs are here they are filled by Marylanders. In addition, the Department of Housing and Community Development is promoting its homebuyer programs to relocating families and aligning community development and rental housing programs to be responsive to BRAC needs in local communities.

Preparations by Local Governments

Several jurisdictions – Anne Arundel, Baltimore, Carroll, Cecil, Frederick, Harford, Howard, Montgomery, Prince George’s, Queen Anne’s, and Talbot counties, Baltimore City, and the City of Laurel – have been actively engaged in BRAC preparation efforts. They have formed regional alliances, have been meeting and working with MMIC and the subcabinet, and have prepared BRAC action plans. Many jurisdictions have established web sites relating to BRAC; created a BRAC office, task force, or implementing commission; and/or appointed a BRAC director. A number of the jurisdictions have also applied for and received federal grants to address BRAC-related issues such as transportation, housing, utilities, services, and education.

Local Government

State Aid to Local Governments

Local governments will realize a modest increase in State aid in fiscal 2010, most of which is targeted to public schools, libraries, and community colleges. State aid is projected to total \$6.8 billion in fiscal 2010, a \$261.5 million or 4.0 percent increase over the prior year.

State Aid in Fiscal 2010

Local governments will receive approximately \$6.8 billion in State aid in fiscal 2010, which represents a 4.0 percent increase from the prior year resulting in an additional \$261.5 million in State support for local programs and services. Local school systems will receive \$5.6 billion in State support, a \$218.0 million increase over fiscal 2009. State aid for libraries and local community colleges will increase by around 10 and 19 percent respectively in fiscal 2010, resulting in an additional \$6.2 million for public libraries and \$49.4 million in additional funding for local community colleges. Local health departments will receive a \$2.2 million or 3.3 percent increase over the prior year, while State aid for counties and municipalities will decrease by \$14.4 million or 1.8 percent. **Exhibit 1** shows the change in State aid by governmental entity for fiscal 2010.

Exhibit 1
State Aid to Local Governments
(\$ in Millions)

<u>Governmental Entity</u>	<u>FY 2009</u>	<u>FY 2010</u>	<u>\$ Difference</u>	<u>% Difference</u>
Public Schools	\$5,352.0	\$5,570.1	\$218.0	4.1%
Counties/Municipalities	820.9	806.5	-14.4	-1.8%
Community Colleges	254.7	304.2	49.4	19.4%
Libraries	63.8	70.0	6.2	9.8%
Local Health Departments	67.0	69.2	2.2	3.3%
Total	\$6,558.4	\$6,819.9	\$261.5	4.0%

Source: Department of Legislative Services

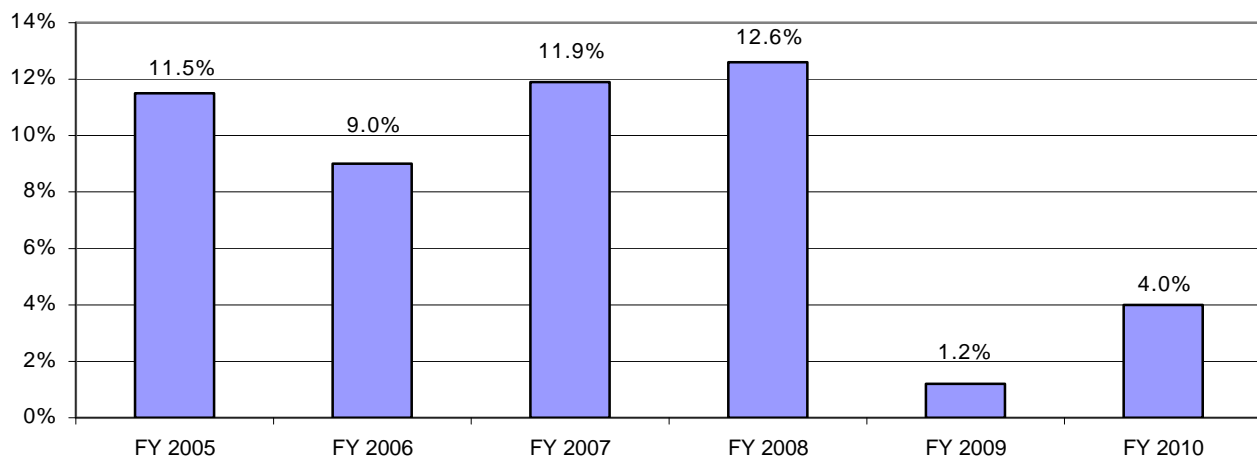
Mid-year Reductions by Board of Public Works

After several years of record increases in State aid (**Exhibit 2**), the General Assembly approved legislation at the 2007 special session that reduced funding for several State aid

programs beginning in fiscal 2009. The General Assembly made additional State aid reductions at the 2008 session as part of the State's cost containment measures. Together, these reductions totaled approximately \$250 million in fiscal 2009. Even with the reductions, most local governments would realize an increase in State aid in fiscal 2009, with most of the increases targeted to public schools, libraries, and community colleges.

With the slowdown in the State's economy continuing to dampen State revenue collections, the Board of Public Works in October approved a \$14.8 million mid-year reduction to State aid programs in fiscal 2009. The reductions affected funding for education, community colleges, public safety, and local health programs as shown in **Exhibit 3**. Overall, the reductions represent only 0.2 percent of total State aid to local governments. The net fiscal effect on State aid to local governments in fiscal 2009 is presented in **Exhibit 4**.

Exhibit 2
Annual Growth in State Aid to Local Governments
General and Special Funds



Source: Department of Legislative Services

Exhibit 3
Fiscal Effect on State Aid to Local Governments in Fiscal 2009
Mid-year Reductions by Board of Public Works

County	Education Aid	Community Colleges	Local Health Grants	Police Aid	Law Enforcement Grants	Total Effect
Allegany	-\$9,170	-\$192,956	-\$42,399	-\$6,640	\$0	-\$251,166
Anne Arundel	-17,760	-1,125,234	-149,147	-50,898	0	-1,343,038
Baltimore City	-40,923	0	-316,472	-634	0	-358,029
Baltimore	-43,980	-1,452,863	-205,645	-74,373	0	-1,776,861
Calvert	-2,129	-75,585	-17,820	-6,049	0	-101,583
Caroline	-3,135	-46,282	-25,007	-2,629	0	-77,054
Carroll	-3,056	-269,615	-57,988	-12,293	0	-342,952
Cecil	-160,423	-182,089	-38,021	-7,296	0	-387,828
Charles	-8,307	-272,277	-47,028	-9,428	0	-337,039
Dorchester	-3,884	-42,512	-20,015	-2,914	0	-69,325
Frederick	-8,990	-322,641	-71,326	-17,555	0	-420,512
Garrett	-5,122	-93,221	-20,350	-1,820	0	-120,513
Harford	-12,979	-409,118	-81,964	-20,950	0	-525,012
Howard	-4,683	-499,527	-58,052	-26,564	0	-588,826
Kent	-2,396	-21,401	-15,586	-1,540	0	-40,922
Montgomery	-41,311	-1,517,417	-146,183	-115,922	0	-1,820,833
Prince George's	-85,378	-919,285	-238,947	-108,248	0	-1,351,858
Queen Anne's	-849	-59,681	-19,600	-3,126	0	-83,256
St. Mary's	-4,776	-87,801	-38,042	-6,463	0	-137,082
Somerset	-3,113	-27,486	-19,934	-1,906	0	-52,440
Talbot	-4,770	-50,990	-15,422	-3,107	0	-74,289
Washington	-14,970	-275,235	-64,778	-11,099	0	-366,082
Wicomico	-11,522	-174,315	-44,440	-7,680	0	-237,957
Worcester	-6,185	-65,439	-14,905	-5,387	0	-91,916
Unallocated	-3,305,900	0	0	0	-612,772	-3,918,672
Total	-\$3,805,711	-\$8,182,970	-\$1,769,072	-\$504,520	-\$612,772	-\$14,875,045

Source: Department of Legislative Services

Exhibit 4
Change in State Aid to Local Governments in Fiscal 2009
Mid-year Reductions by Board of Public Works

County	FY 2008 Allowance	FY 2009 Allowance	Difference Over Prior Year	Percent Difference	BPW Reduction	FY 2009 Revised	Difference Over Prior Year	Percent Difference
Allegany	\$114,915,833	\$118,749,891	\$3,834,058	3.3%	-\$251,166	\$118,498,725	\$3,582,892	3.1%
Anne Arundel	410,657,413	416,498,615	5,841,202	1.4%	-1,343,038	415,155,577	4,498,164	1.1%
Baltimore City	1,244,405,240	1,244,185,649	-219,591	0.0%	-358,029	1,243,827,620	-577,620	0.0%
Baltimore	700,009,650	708,164,268	8,154,618	1.2%	-1,776,861	706,387,407	6,377,757	0.9%
Calvert	113,375,235	110,440,636	-2,934,599	-2.6%	-101,583	110,339,053	-3,036,182	-2.7%
Caroline	56,166,123	57,729,453	1,563,330	2.8%	-77,054	57,652,399	1,486,276	2.6%
Carroll	188,369,898	191,681,491	3,311,593	1.8%	-342,952	191,338,539	2,968,641	1.6%
Cecil	125,436,466	127,412,672	1,976,206	1.6%	-387,828	127,024,844	1,588,378	1.3%
Charles	187,932,393	193,029,507	5,097,114	2.7%	-337,039	192,692,468	4,760,075	2.5%
Dorchester	44,322,743	44,874,131	551,388	1.2%	-69,325	44,804,806	482,063	1.1%
Frederick	259,206,107	268,611,813	9,405,706	3.6%	-420,512	268,191,301	8,985,194	3.5%
Garrett	42,248,291	42,435,013	186,722	0.4%	-120,513	42,314,500	66,209	0.2%
Harford	273,137,033	276,083,546	2,946,513	1.1%	-525,012	275,558,534	2,421,501	0.9%
Howard	266,394,268	279,588,855	13,194,587	5.0%	-588,826	279,000,029	12,605,761	4.7%
Kent	17,032,970	17,071,367	38,397	0.2%	-40,922	17,030,445	-2,525	0.0%
Montgomery	648,788,378	659,173,241	10,384,863	1.6%	-1,820,833	657,352,408	8,564,030	1.3%
Prince George's	1,128,465,078	1,139,540,888	11,075,810	1.0%	-1,351,858	1,138,189,030	9,723,952	0.9%
Queen Anne's	44,020,951	45,077,006	1,056,055	2.4%	-83,256	44,993,750	972,799	2.2%
St. Mary's	114,265,121	120,254,006	5,988,885	5.2%	-137,082	120,116,924	5,851,803	5.1%
Somerset	36,139,077	36,178,595	39,518	0.1%	-52,440	36,126,155	-12,922	0.0%
Talbot	21,416,817	21,402,314	-14,503	-0.1%	-74,289	21,328,025	-88,792	-0.4%
Washington	176,093,437	181,359,394	5,265,957	3.0%	-366,082	180,993,312	4,899,875	2.8%
Wicomico	133,408,815	140,405,223	6,996,408	5.2%	-237,957	140,167,266	6,758,451	5.1%
Worcester	34,565,454	34,298,511	-266,943	-0.8%	-91,916	34,206,595	-358,859	-1.0%
Unallocated	100,146,528	99,007,523	-1,139,005	-1.1%	-3,918,672	95,088,851	-5,057,677	-5.1%
Total	\$6,480,919,319	\$6,573,253,608	\$92,334,289	1.4%	-\$14,875,045	\$6,558,378,563	\$77,459,244	1.2%

Source: Department of Legislative Services

Local Government

Local Tax and Salary Actions

Local tax rates remained relatively stable in fiscal 2009, while most county governments and local boards of education provided salary enhancements to their employees.

Local Government Tax Rates

Seven counties changed various local tax rates in fiscal 2009, with five decreasing rates and two increasing them. As shown in **Exhibit 1**, five jurisdictions reduced property taxes in fiscal 2009 due to growth in property tax assessments that have pushed local revenues upward. Local income tax rates remained relatively constant for tax year 2009, with only one county increasing its rate. Additionally, one county increased its recordation tax rates, and one county increased its hotel/motel tax rates. A comparison of local tax rates for fiscal 2008 and 2009 is provided in **Exhibit 2**.

Exhibit 1
Number of Counties Changing Local Tax Rates
Fiscal 2005-2009

	<u>Fiscal 2005</u>		<u>Fiscal 2006</u>		<u>Fiscal 2007</u>		<u>Fiscal 2008</u>		<u>Fiscal 2009</u>	
	▲	▼	▲	▼	▲	▼	▲	▼	▲	▼
Real Property	2	6	0	13	0	17	1	5	0	5
Local Income	1	1	0	1	0	1	1	0	1	0
Recordation	1	0	1	0	0	0	2	0	1	0
Transfer	0	0	1	0	0	0	0	0	0	0
Admissions/Amusement	0	0	0	0	0	1	0	0	0	0
Hotel/Motel	5	0	5	0	0	0	0	0	1	0

Note: ▲ represents a tax rate increase. ▼ represents a tax rate decrease.

Source: 2008 Local Government Tax Rate and Salary Action Survey, Department of Legislative Services

Exhibit 2
Local Tax Rates – Fiscal 2008 and 2009

County	<u>Real Property</u>		<u>Local Income</u>		<u>Recordation</u>		<u>Transfer</u>		<u>Admissions/ Amusement</u>		<u>Hotel/Motel</u>	
	2008	2009	2008	2009	2008	2009	2008	2009	2008	2009	2008	2009
Allegany	\$0.983	\$0.983	3.05%	3.05%	\$3.25	\$3.25	0.50%	0.50%	7.5%	7.5%	8.0%	8.0%
Anne Arundel	0.891	0.888	2.56%	2.56%	3.50	3.50	1.00%	1.00%	10.0%	10.0%	7.0%	7.0%
Baltimore City	2.268	2.268	3.05%	3.05%	5.00	5.00	1.50%	1.50%	10.0%	10.0%	7.5%	7.5%
Baltimore	1.100	1.100	2.83%	2.83%	2.50	2.50	1.50%	1.50%	10.0%	10.0%	8.0%	8.0%
Calvert	0.892	0.892	2.80%	2.80%	5.00	5.00	0.00%	0.00%	1.0%	1.0%	5.0%	5.0%
Caroline	0.870	0.870	2.63%	2.63%	5.00	5.00	0.50%	0.50%	0.0%	0.0%	5.0%	5.0%
Carroll	1.048	1.048	3.05%	3.05%	5.00	5.00	0.00%	0.00%	10.0%	10.0%	5.0%	5.0%
Cecil	0.960	0.960	2.80%	2.80%	4.10	4.10	0.00%	0.00%	6.0%	6.0%	5.0%	5.0%
Charles	1.026	1.026	2.90%	2.90%	5.00	5.00	0.00%	0.00%	10.0%	10.0%	5.0%	5.0%
Dorchester	0.896	0.896	2.62%	2.62%	5.00	5.00	0.75%	0.75%	0.5%	0.5%	5.0%	5.0%
Frederick	1.064	1.064	2.96%	2.96%	6.00	6.00	0.00%	0.00%	5.0%	5.0%	3.0%	3.0%
Garrett	1.000	1.000	2.65%	2.65%	3.50	3.50	1.00%	1.00%	4.5%	4.5%	5.0%	5.0%

County	<u>Real Property</u>		<u>Local Income</u>		<u>Recordation</u>		<u>Transfer</u>		<u>Admissions/ Amusement</u>		<u>Hotel/Motel</u>	
	2008	2009	2008	2009	2008	2009	2008	2009	2008	2009	2008	2009
Harford	1.082	1.082	3.06%	3.06%	3.30	3.30	1.00%	1.00%	5.0%	5.0%	0.0%	0.0%
Howard	1.150	1.150	3.20%	3.20%	2.50	2.50	1.00%	1.00%	7.5%	7.5%	5.0%	5.0%
Kent	0.972	0.972	2.85%	2.85%	3.30	3.30	0.50%	0.50%	4.5%	4.5%	5.0%	5.0%
Montgomery	0.916	0.915	3.20%	3.20%	3.45	3.45	1.00%	1.00%	7.0%	7.0%	7.0%	7.0%
Prince George's	1.319	1.319	3.10%	3.20%	2.20	2.50	1.40%	1.40%	10.0%	10.0%	5.0%	5.0%
Queen Anne's	0.770	0.770	2.85%	2.85%	3.30	3.30	0.50%	0.50%	5.0%	5.0%	5.0%	5.0%
St. Mary's	0.857	0.857	3.00%	3.00%	4.00	4.00	1.00%	1.00%	2.0%	2.0%	5.0%	5.0%
Somerset	0.940	0.920	3.15%	3.15%	3.30	3.30	0.00%	0.00%	4.0%	4.0%	5.0%	5.0%
Talbot	0.475	0.449	2.25%	2.25%	3.30	3.30	1.00%	1.00%	5.0%	5.0%	4.0%	4.0%
Washington	0.948	0.948	2.80%	2.80%	3.80	3.80	0.50%	0.50%	5.0%	5.0%	6.0%	6.0%
Wicomico	0.881	0.814	3.10%	3.10%	3.50	3.50	0.00%	0.00%	6.0%	6.0%	6.0%	6.0%
Worcester	0.700	0.700	1.25%	1.25%	3.30	3.30	0.50%	0.50%	3.0%	3.0%	4.0%	4.5%

Notes: The real property tax rates shown for Charles, Frederick, Howard, Montgomery, and Prince George's counties include special tax rates. Real property tax is per \$100 of assessed value. Income is a percentage of taxable income. Recordation tax is per \$500 of transaction.

Source: 2008 Local Government Tax Rate and Salary Action Survey, Department of Legislative Services

Property Tax

For fiscal 2009, five jurisdictions – Anne Arundel, Montgomery, Somerset, Talbot, and Wicomico – decreased their real property tax rates. Real property tax rates range from \$0.449 per \$100 of assessed value in Talbot County to \$2.268 per \$100 of assessed value in Baltimore City.

Local Income Tax

Prince George's County was the only jurisdiction to alter its local income tax rate for calendar 2009, increasing it from 3.10 to 3.20 percent. Local income tax rates range from 1.25 percent in Worcester County to 3.20 percent in Howard, Montgomery, and Prince George's counties.

Recordation Tax

One county increased its recordation tax rate for fiscal 2009 – Prince George's County increased its rate from \$2.20 to \$2.50 per \$500 of transaction. The range for recordation tax rates is \$2.50 per \$500 of transaction in Baltimore, Howard, and Prince George's counties to \$6.00 per \$500 of transaction in Frederick County.

Transfer Tax

No county changed its transfer tax rate for fiscal 2009. Local transfer tax rates range from 0.5 percent in six counties (Allegany, Caroline, Kent, Queen Anne's, Washington, and Worcester) to 1.5 percent in Baltimore City and Baltimore County. Seven counties (Calvert, Carroll, Cecil, Charles, Frederick, Somerset, and Wicomico) do not impose a tax on property transfers.

Admissions and Amusement Tax

No county changed its admissions and amusement tax rate for fiscal 2009. Admissions and amusement tax rates range from 0.5 percent in Dorchester County to 10.0 percent in six jurisdictions – Baltimore City, and Anne Arundel, Baltimore, Carroll, Charles, and Prince George's counties. Caroline County is the only jurisdiction that does not impose an admissions and amusement tax.

Hotel and Motel Tax

Worcester County was the only jurisdiction to change its hotel and motel tax rate for fiscal 2009, increasing it from 4.0 to 4.5 percent. Hotel and motel tax rates range from 3.0 percent in Frederick County to 8.0 percent in Allegany and Baltimore counties. Harford County is the only jurisdiction that does not impose a hotel and motel tax.

Tax Limitation Measures

Five charter counties (Anne Arundel, Montgomery, Prince George's, Talbot, and Wicomico) have amended their charters to limit property tax rates or revenues. In Anne Arundel County, the total annual increase in property tax revenues is limited to the lesser of 4.5 percent or the increase in the consumer price index. In Montgomery County, the growth in property tax revenues is limited to the increase in the consumer price index; however, this limitation does not apply to new construction. In addition, the limitation may be overridden by a unanimous vote of all nine county council members. In Prince George's County, the general property tax rate is capped at \$0.96 per \$100 of assessed value. Special taxing districts, such as the Maryland-National Capital Park and Planning Commission, are not included under the tax cap. In Talbot and Wicomico counties, the total annual increase in property tax revenues is limited to the lesser of 2 percent or the increase in the consumer price index.

The charter limit on property taxes in Montgomery County was strengthened at the November 2008 general election, when county voters approved by a narrow margin an amendment to the county charter (Question B) that requires a unanimous vote of all nine county council members in order to override the county's property tax limitation provision. Prior to this amendment, the property tax limitation could be overridden by an affirmative vote of seven of the nine council members. Since 1990, when county voters approved the charter limit on property taxes, the county council has set tax rates that exceeded the limit four times. In fiscal 2009, among the state's 24 jurisdictions, Montgomery County has the fifteenth highest property tax rate.

County Salary Actions

Almost all Maryland jurisdictions provided salary enhancements to their employees in fiscal 2009. Twenty county governments provided their employees with a cost-of-living adjustment (COLA) and 20 counties provided step increases. Moreover, 22 boards of education provided COLAs and 20 boards provided step increases for teachers. **Exhibit 3** compares local salary actions in fiscal 2008 and 2009, while **Exhibit 4** shows specific local salary actions for fiscal 2009. The majority of counties (13) and local boards of education (16) provided their employees and teachers, respectively, with a COLA of at least 3 percent. Three counties (Baltimore, Caroline, and Washington) and one board of education (Baltimore County) did not provide a COLA. For comparison purposes, the State provided its employees with a 2 percent COLA in fiscal 2009. Local government information for Baltimore City and board of education information for Prince George's County was not available.

Exhibit 3
Local Government Salary Actions – Summary
Fiscal 2008 and 2009

<u>COLA Amount¹</u>	County Government		Public Schools	
	<u>Fiscal 2008</u>	<u>Fiscal 2009</u>	<u>Fiscal 2008</u>	<u>Fiscal 2009</u>
No COLA	0	3	0	1
1% to 2.9%	11	7	0	6
3% to 3.9%	8	9	2	6
4% to 4.9%	3	3	9	5
5% to 5.9%	1	0	8	3
6% and Greater	1	1	5	2
Pending	0	1	0	1

COLA: Cost-of-living adjustment

¹ The COLA amount includes market adjustments.

Exhibit 4
Local Government Salary Actions in Fiscal 2009

County	County Government		Board of Education Teachers		Comments
	COLA	Step	COLA	Step	
Allegany ¹	3.0%	Yes	6.0%	Yes	¹ Allegany County road and nursing home employees received a 5.0% COLA, and E-9-1-1 communications, animal control, detention center, and sheriff's employees received a 5.5% COLA.
Anne Arundel ²	3.0%	Yes	5.0%	Yes	
Baltimore City ³	Pending	Pending	4.0%	Yes	
Baltimore	0.0%	Yes	0.0%	Yes	² Anne Arundel County teaching assistants and board of education secretaries, operations, maintenance, transportation, and food service employees received a 3.0% COLA; while school administrators received a 6.0% COLA.
Calvert	3.3%	Yes	4.5%	Yes	
Caroline	0.0%	Yes	2.0%	Yes	
Carroll	2.0%	Yes	2.0%	No	³ Baltimore City fire officers received a 3.0% COLA and managerial employees received a 2.0% COLA. Salary adjustments for nurses and general, police, and technical employees are still pending.
Cecil	3.0%	Yes	4.0%	Yes	
Charles	2.0%	Yes	3.5%	Yes	
Dorchester	3.0%	No	1.6%	Yes	⁴ Garrett County employees received a \$750 across-the-board increase; however, employees represented by AFSCME received a 4.0% COLA.
Frederick	2.0%	Yes	2.0%	Yes	
Garrett ⁴	4.0%	Yes	6.0%	Yes	
Harford ⁵	6.0%	Yes	1.6%	Yes	⁵ Harford County employees received a 3.0% COLA and a 3.0% market adjustment.
Howard ⁶	3.0%	Yes	5.0%	Yes	
Kent	2.0%	Yes	3.0%	Yes	
Montgomery ⁷	4.5%	Yes	5.0%	Yes	⁶ Howard County police personnel received a 5.0% COLA and fire personnel received a 6.0% COLA. Corrections, blue collar, and dispatchers received a 3.0% COLA. School administrators received a 4.75% COLA.
Prince George's ⁸	2.5%	Yes	Pending	Pending	
Queen Anne's ⁹	\$1,800	No	3.5%	Yes	
St. Mary's	3.0%	Yes	4.0%	Yes	⁷ Montgomery County police and fire personnel received a 4.0% COLA.
Somerset ¹⁰	2.5%	Yes	4.0%	Yes	
Talbot ¹¹	2.5%	Yes	3.5%	Yes	
Washington	0.0%	Yes	2.0%	Yes	⁸ Prince George's County police, corrections, and sheriff personnel received a 3.0% COLA.
Wicomico	3.0%	No	3.0%	No	
Worcester	3.5%	Yes	3.5%	Yes	
Number Granting	20	20	22	21	⁹ Queen Anne's County school administrators and support staff received a 2.0% COLA.

Source: American Federation of State, County and Municipal Employees

¹⁰Somerset County school administrators and classified employees received a 3.5% COLA.

¹¹Talbot County school administrators received a 2.5% COLA.

Local Government

2009 Legislative Agenda – Maryland Municipal League

The legislative agenda for the Maryland Municipal League includes granting additional local governments the authority to implement traffic speed monitoring systems, establishing a task force to study municipal government revenues, and enhancing energy assistance programs.

Speed Monitoring Systems

State law authorizes the use of speed monitoring systems (also known as speed cameras or automated radar camera systems) to help apprehend speeders only in Montgomery County and municipal corporations in Montgomery County. Automated radar camera systems in these jurisdictions are authorized for use only in residential districts and school zones, and the results thus far have demonstrated improvements in driver behavior and traffic and pedestrian safety statistics.

In the past, the Maryland Municipal League (MML) has supported legislation that would have authorized local governments throughout the State to use automated radar camera systems to help apprehend speeders. It is MML's position that the need for speed control is especially critical in residential districts and school zones, and it will work to enact legislation in 2009 to grant all local governments the authority to use automated radar camera technology to issue speeding citations in residential districts and school zones. For more information, see the issue paper entitled "Speed Cameras" under the Criminal Law heading.

Taskforce to Study Municipal Government Revenues

MML will support legislation to establish a task force to study the revenue needs of municipalities and to examine potential alternative revenue sources, such as measures authorizing or expanding existing authority for municipalities to impose hotel or motel rental taxes, building excise taxes, and street utility fees. Additionally, MML will pursue other opportunities that may arise to either introduce or support legislation that would provide new revenue sources for municipalities.

Municipal Energy Assistance Program

MML will work to identify funding in existing energy loan programs, such as the Jane E. Lawton Conservation Loan Program, that may be used for local government energy assistance programs and will propose legislation to enhance existing energy programs that are in the best interest for all local governments.

Local Government

2009 Legislative Agenda – Maryland Association of Counties

The legislative agenda for the Maryland Association of Counties includes protecting State funding to local governments, continuing the State's commitment to public school construction funding, granting additional local governments the authority to implement traffic speed monitoring technology, and enhancing reporting requirements for scrap metal dealers and pawn shops.

Each year, the Maryland Association of Counties (MACo) selects up to four issues as its legislative initiatives for the upcoming session. This year, one of MACo's legislative priorities is to prevent a shift in the responsibility for funding certain government programs from the State to the local level. As a result of the slowdown in the State's economy, MACo anticipates that the State will seek to contain costs in part by reducing funding for local government. MACo also supports school construction funding at the Capital Debt Affordability Committee's recommended level of \$325 million. The two remaining priorities involve statewide implementation of speed monitoring systems and greater regulation of scrap metal transactions toward the goal of reducing related property crime and theft.

County Budget Security

State aid continues to be the largest revenue source for most county governments, representing 26.5 percent of total county revenues. Over the last five years, State funding for local governments has increased by \$2.1 billion or 44.5 percent, even though the State faced major fiscal challenges during most of this period. The recent slowdown in the State's economy and volatile financial markets present new challenges as State revenues fall below projections. Since State aid to local governments represents one of the largest components of the State budget¹, some individuals have advocated a shift of funding responsibility to counties for any number of shared responsibilities in education, public safety, public health, and elsewhere – a cost shift that could impact county budgets and taxes. MACo urges State policymakers to manage State expenditures responsibly, and not to shift responsibilities to county officials.

School Construction and Renovation Funding

While the State has increased its school construction and renovation efforts in recent years, the need for funding remains high. MACo urges the General Assembly to continue its commitment by keeping school construction and renovation funding a high priority and adopting

¹ State aid to local governments represents approximately 40 percent of State general fund revenues and 27 percent of both general and special fund revenues.

the Capital Debt Affordability Committee's recommended level of \$325 million for school projects for fiscal 2010, \$75 million above the planned \$250 million in the Governor's *Capital Improvement Program*. **Exhibit 1** shows State funding for public school construction for fiscal 2005 through 2009.

Exhibit 1
State Funding for Public School Construction

<u>FY 2005</u>	<u>FY 2006</u>	<u>FY 2007</u>	<u>FY 2008</u>	<u>FY 2009</u>
\$125,878,000	\$253,766,000	\$322,672,000	\$401,828,000	\$340,010,000

Source: Public School Construction Program; Department of Legislative Services

Speed Monitoring Systems

According to MACo, speed monitoring systems (also known as speed cameras) have been shown to reduce dangerous speeding on public roadways, with a commensurate reduction in serious crashes and injuries. MACo encourages the State to authorize local governments statewide to implement speed cameras in residential areas and school zones and issue civil citations to registered vehicle owners for violations. House Bill 443 of the 2005 session gave Montgomery County and municipal corporations in Montgomery County authority to use speed cameras. The bill became law in February 2006 following a veto override. Montgomery County is required to report to the General Assembly on the effectiveness of speed monitoring systems by December 31, 2009. Currently, no other county may use speed cameras. For further information, see the issue paper entitled "Speed Cameras" under the Criminal Law heading.

Scrap Metal Dealers and Pawnshops

The availability of simple, largely anonymous, cash transactions for metal objects has fostered widespread property crime and theft. According to MACo, greater regulation of transactions and the individuals submitting items for purchase at a dealer will enable law enforcement to better react when stolen property has been reported, and to better track down offenders through these transactions. The anticipated result is an overall cooling in the "easy money" market for stolen metal and semi-valuable goods through these scrap dealers and pawnshops.